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## Forgotten Borrowers: Protecting Private Student Loan Borrowers Through State Law

Prentiss Cox

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# Forgotten Borrowers: Protecting Private Student Loan Borrowers Through State Law

Prentiss Cox,\* Judith Fox,\*\* & Stacey Tutt\*\*\*

*Private student loan borrowers arguably have the fewest protections of any users of credit in the United States. In a scarcely debated amendment to federal bankruptcy law in 2005, private student lenders gained the same protections against discharge previously afforded to federal student lenders. Yet private student loan borrowers received none of the rights available to federal student loan borrowers. These include income-driven repayment, relief from repayment on disability, loan discharge for fraud or closed schools, and public service loan forgiveness. Private student loan borrowers thus have neither the bankruptcy protections afforded to nonstudent loan debtors nor the repayment and debt relief rights of student borrowers under the federal loan program.*

*This lack of consumer protection has particular consequence when considering the plight of for-profit school students saddled with private student loans. Some of the worst abuses in the proliferation of higher education debt have been perpetrated against for-profit school attendees. The vast majority of private student loans are cosigned, typically by older family members. This combination of private student loans and for-profit school attendance impacts a much broader range of consumers than would a comparable number of federal student loans.*

*We suggest two types of state legislation to protect these debtors. For prospective for-profit school private borrowers, we propose incorporating some of the protections of federal student loans through the use of a state equivalent to the Federal Trade Commission “Holder Rule.” For all private student loans, we propose a requirement that private lenders engage in a mandatory settlement process, similar to those used by states during the recent foreclosure crisis, as a prerequisite to using state courts for debt collection.*

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## INTRODUCTION

Private student loan borrowers have the weakest consumer financial protections of any group of borrowers. They generally have no right to discharge their private student loans in bankruptcy, yet they have none of the repayment options and debt relief rights that accompany federal student loans. Unlike many other types of consumer lending substantially left to state law, such as payday loans or motor vehicle loans, state law protections for private student loan borrowers are nonexistent in most states.

This lack of protection has particular meaning for higher education students attending for-profit schools. The fraudulent marketing and abusive lending practices in for-profit higher education is well documented. Also well-established is the history of state and federal regulators failing to control these abuses or, in many instances, actually abetting the proliferation of these schools. When these unfair and deceptive practices result in former students burdened with private student loans that lack basic protections, the result is a group of debtors who have been forgotten under consumer protection law.

In this Article, we argue for two types of legislation that can be enacted by states to protect these borrowers. First, we propose the Private Student Borrower Protection Act, which would require a private student loan contract for attending a for-profit school to incorporate a specific set of rights afforded to federal student loan borrowers. We use the concept underlying the Federal Trade Commission (FTC) “Holder Rule” to accomplish this goal. This state legislation would apply to future private student loan borrowers attending for-profit schools.

Second, we propose the Private Student Loan Mediation Act, which would require mediation before any judgment is entered for nonpayment of any private student loan. We use the successful mortgage mediation state laws instituted in the aftermath of the financial crisis as a model for this legislation. The proposed legislation would require private lenders to engage in good faith mediation, which the legislation would presume exists if the lender affords the private student loan borrower repayment and debt relief rights that are analogous to those provided in the federal student loan program.

In Part I of this Article, we describe the daunting problem facing former for-profit school students indebted on private student loans. The number of private loans dropped during the Great Recession but are again on the rise. Students who attend for-profit schools find themselves with high levels of student loan debt and, more often than not, cannot qualify for the employment their school promised. Private student loans do not provide borrowers with the same protections that accompany federal student loans but face the same restrictions on bankruptcy. Congress left little legislative footprint in 2005 when it brought the massive volume of private student loans under the exemption from bankruptcy that had long applied to federal student loans.

In Parts II and III of this Article, we set forth the structure and rationale for the two legislative proposals. We describe the existing regulatory frameworks that

we use for creating consumer protection—the FTC Holder Rule and state mortgage mediation laws. We then describe the scope of the laws and the specific protections that are afforded to covered borrowers. Finally, a model state law is included in an appendix for each of the legislative proposals.

# I. ABUSES AND MISSING LEGAL PROTECTIONS IN PRIVATE LENDING TO FOR-PROFIT SCHOOL STUDENTS

Private student loans make up a small portion of the entire student loan pie, but it is a trillion-dollar pie.<sup>1</sup> Even a small portion of such an industry can have an impact on borrowers and their communities. To understand this sector of the industry, it is first necessary to examine how it developed and grew to be such a force in student borrowing.

## A. Rise and Fall and (Partial) Resurrection of Private Student Loans

The federal government first waded into the funding of college educations after World War II. The Serviceman’s Readjustment Act of 1944 provided money for soldiers returning from World War II to get an education.<sup>2</sup> The Higher Education Act of 1965 was the first to provide broad, needs-based financial aid in the form of grants, loans, and work-study programs.<sup>3</sup> In 1972, the Pell grant program was created to provide more grants, as opposed to loans, for students. As a result, from 1970 to 1979, grants surpassed student borrowing.<sup>4</sup> In the 1980s, the Reagan administration took several steps to shift the burden of funding higher education from the government to the student.<sup>5</sup>

Most students obtain a federal subsidized loan better known as the Stafford loan. The size of the Stafford loan is regulated by the federal government.<sup>6</sup> Students complete an application and the Department of Education calculates the “Expected Family Contribution.” This is the amount the student and her parents are required to pay. This information is then sent to the school, which calculates the cost of

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1. ELAN AMIR, JARED TESLOW & CHRISTOPHER BORDERS, MEASUREONE, THE MEASURE ONE PRIVATE STUDENT LOAN REPORT (2019), <https://cdn2.hubspot.net/hubfs/6171800/assets/downloads/MeasureOne%20Private%20Student%20Loan%20Report%20Q3%202019.pdf> [https://perma.cc/5VYJ-PZ2J].

2. Servicemen’s Readjustment Act of 1944, Pub. L. No. 78-346, 58 Stat. 284 (codified as amended in scattered sections of 38 U.S.C.).

3. Higher Education Act of 1965, Pub. L. No. 89-329, 79 Stat. 1219 (codified as amended at 20 U.S.C. § 1070).

4. Linda E. Coco, *Mortgaging Human Potential: Student Indebtedness and the Practices of the Neoliberal State*, SW. L. REV. 565, 584 (2013).

5. *Id.* at 585–86.

6. The banking industry has been lobbying recently to decrease the size of the graduate school and parent plus loans, which would invariably push more people into the private student loan market. While unsuccessful so far, these efforts have the support of Betsy DeVos’s Department of Education. Christopher K. Odinet, *The New Data of Student Debt*, 92 S. CAL. L. REV. 1617, 1624 (2019).

attendance. The federal subsidized loans and grants are set based on those costs.<sup>7</sup> The good news for students is that these federal loans do not require a credit check. Most students have no credit history and would not qualify for an unsecured loan of the size necessary to attend college. The problem, however, is that if the family cannot meet the Expected Family Contribution, the student and her parents are forced to try other options. Private student loans are one such option.

Private entities have been involved in the student loan market since at least the 1960s. From 1965 until 2010, federal student loans were originated by private lenders, but backed by the federal government. Private lenders also offered student loans without federal guarantees, often as a companion to the federally guaranteed loan.<sup>8</sup> This all changed in 2010 with the Student Aid and Fiscal Responsibility Act, which eliminated the private lender intermediary for federal loans.<sup>9</sup> From 2010 forward, federal student loans were made directly by the government to the student, resulting in a clear distinction between federal student loans made by the government with no private lender intermediary and a fully private student loan with no government guarantee or involvement, which is the subject of this Article.

The private student loan market exploded and fell in tandem with the subprime mortgage market in the 2000s. It grew from less than \$5 billion in 2001 to over \$20 billion in 2008, accounting for a quarter of all student loans that year.<sup>10</sup> The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)<sup>11</sup> afforded private student lenders protection against student-declared bankruptcy, something already enjoyed by federally guaranteed student lenders. There are two arguments for allowing this special protection in bankruptcy. The first is to bring down the cost of credit, or the so-called bankruptcy tax.<sup>12</sup> The second is to decrease the risk to lenders, thereby incentivizing them to increase the available credit. A study of private student loans before and after BAPCPA confirmed the latter, but not the former.<sup>13</sup> The number of loans increased significantly during the period immediately following BAPCPA, and the credit profile of the borrowers decreased slightly.<sup>14</sup> However, the cost of the loans actually

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7. CONSUMER FIN. PROT. BUREAU, PRIVATE STUDENT LOANS: REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, THE SENATE COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS, THE HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES, AND THE HOUSE OF REPRESENTATIVES COMMITTEE ON EDUCATION AND THE WORKFORCE 10 (2012) [hereinafter PRIVATE STUDENT LOANS], [https://files.consumerfinance.gov/f/201207\\_cfpb\\_Reports\\_Private-Student-Loans.pdf](https://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf) [<https://perma.cc/6MHK-PX8N>].

8. *Id.* at 9–13 (tracing history of private student loans).

9. Student Aid and Fiscal Responsibility Act of 2010, Pub. L. No. 111-152, 1254 Stat. 107.

10. PRIVATE STUDENT LOANS, *supra* note 7, at 17.

11. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23.

12. Xiaoling Ang & Dalié Jiménez, *Private Student Loans and Bankruptcy: Did Four-Year Undergraduates Benefit from Increased Collectability of Student Loans?*, Upjohn Press (forthcoming) (manuscript at 175–76), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2332284](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2332284) [<https://perma.cc/74LB-FZVW>] (Mar. 12, 2018).

13. *Id.* at 206.

14. *Id.* at 213.

increased.<sup>15</sup> As we saw in the subprime mortgage crisis, the amount of credit increased, but it increased at a significant cost to the borrowers.

The Great Recession that followed had an immediate effect on this market, and both the size and number of private loans plummeted. In the 2010–2011 academic year, they accounted for only seven percent of the market.<sup>16</sup> Although modest, they are experiencing somewhat of a comeback. As of June 30, 2019, private student loans comprised 7.76% of the market.<sup>17</sup> While this may seem to be a very small share of a market—too small, perhaps, to raise concern—it is important to remember the massive size of that market, for which 7.76% represents more than \$124 billion dollars in loans.<sup>18</sup>

Private student loans require credit checks, and as a result, the majority of private student loans have cosigners, usually parents.<sup>19</sup> Parents can also apply for federal Parent Plus loans. These loans, though subsidized, do not offer some of the repayment protections offered by the loans made directly to students.<sup>20</sup> Federally subsidized loans have fixed interest rates, though those rates can change.<sup>21</sup> Federal graduate loans also have a fixed rate, though more expensive than undergraduate loans.<sup>22</sup> Private loans have variable rates set based on the credit factors of a borrower.<sup>23</sup> While all students who take out a Stafford loan at the same time will pay the same interest rate, if those same students take out a private loan, the interest rates can vary dramatically. An investigation by the Consumer Financial Protection Bureau (CFPB) showed that most private student loans are more expensive than the corresponding Stafford loan.<sup>24</sup> In addition, while the federal government covers the interest on federal loans while a student remains in school, the interest on private loans can begin to accrue the day the loan is made.

Some for-profit schools became very creative in the way in which they financed student attendance. They attempt to bypass the federal student loan market altogether. This seriously disadvantages their students because the loans are more expensive and come without any of the repayment advantages of federal loans.

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15. *Id.*

16. U.S. GOV'T ACCOUNTABILITY OFF., GAO-19-430, PRIVATE STUDENT LOANS: CLARIFICATION FROM CFPB COULD HELP ENSURE MORE CONSISTENT OPPORTUNITIES AND TREATMENT FOR BORROWERS 5 (2019) [hereinafter GAO-19-430], <https://www.gao.gov/assets/700/699338.pdf> [<https://perma.cc/MFA5-G2PP>].

17. AMIR ET AL., *supra* note 1.

18. *Id.*

19. The number of private loans with co-signers has increased significantly post-recession. During the 2019–2020 academic year, ninety-two percent of private undergraduate loans originated required co-signers. AMIR ET AL., *supra* note 1, at 39.

20. *See infra* Section I.C.

21. The Perkins loan is the one type of federal loan with a statutorily fixed interest rate (five percent). However, no new Perkins loans have been made since 2017 when the program expired. Odinet, *supra* note 6, at 1629.

22. *Id.* at 1630.

23. PRIVATE STUDENT LOANS, *supra* note 7, at 12.

24. *Id.* at 14.

The Minnesota School of Business and Globe University were two such institutions operating in Minnesota.<sup>25</sup> The schools offered their students loans of up to \$7,500 at interest rates between twelve and eighteen percent,<sup>26</sup> rates substantially higher than those available through the Stafford program. The students never actually received the funds. Instead, the money was applied to their tuition bill.<sup>27</sup> The state of Minnesota sued the schools alleging they were not licensed in the state to make these loans and that the loans were usurious under state law.<sup>28</sup> The schools claimed the loans were a hybrid product, not a revolving loan subject to the interest rate cap, but also not closed-end credit.<sup>29</sup> As the Minnesota Supreme Court explained, the loans were structured in a way that gave the schools “the benefit of open-end credit plans—charging interest in excess of eight percent—without providing the students the benefits of revolving credit.”<sup>30</sup> The court determined the loans were usurious in violation of Minnesota law.<sup>31</sup>

Innovative loan products can sometimes be beneficial, but as we learned in the subprime mortgage crisis, they are just as often used to disadvantage the unwary.<sup>32</sup> We need to be more diligent when new products appear. One such product has recently entered the market, the income-sharing agreement. Purdue University, a public Indiana college, is the best-known university that has adopted this model, though it has been a favorite of abusive commercial driving schools for decades.<sup>33</sup> The Purdue model is available to students in lieu of Parent Plus or private student loans. Like the schools in Minnesota, they claim it is not a loan.<sup>34</sup> The school does not charge interest, although Purdue is careful to point out that you will pay back more than you received.<sup>35</sup> That sounds like interest. When you graduate, you agree to repay the school a percentage of your income for ten years.<sup>36</sup> The terms of the loan depend on certain underwriting factors but not those traditionally used in lending. Instead, the institution uses what it terms “education factors,” things like

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25. State v. Minn. Sch. of Bus., 899 N.W.2d 467, 468 (Minn. 2017).

26. *Id.* at 469.

27. *Id.*

28. *Id.* at 469–70.

29. *Id.* at 475.

30. *Id.*

31. *Id.*

32. See GEORGE A. AKERLOF & ROBERT J. SHILLER, PHISHING FOR PHOOLS: THE ECONOMICS OF MANIPULATION & DECEPTION (2015) (explaining how if a profit can be made, then people will look for people to deceive).

33. *Income Share Agreements*, PURDUE U., <https://www.purdue.edu/dfa/types-of-aid/income-share-agreement/index.html> [<https://perma.cc/GL8M-HRKW>] (last visited Sept. 27, 2020); see also Robert Farrington, *Be Careful with Income Sharing Agreements (ISAs) to Pay for College*, FORBES (Apr. 12, 2019, 7:48 AM), <https://www.forbes.com/sites/robertfarrington/2019/04/12/income-sharing-agreements-to-pay-for-college/#4aa7a7ea52e0> [<https://perma.cc/4QLX-DCAW>] (explaining why they may be more expensive than student loans).

34. *Back a Boiler Program Overview*, PURDUE U., <https://www.purdue.edu/backaboiler/overview/index.html> [<https://perma.cc/2B4H-QLD3>] (last visited Sept. 27, 2020).

35. *Id.*

36. *Id.*



your major, GPA, or SAT score.<sup>37</sup> The school provides an online tool for you to compare your loan terms based on your major.<sup>38</sup> Most students who enroll in Purdue will graduate,<sup>39</sup> so perhaps for students attending this kind of institution, this is a funding option to consider. However, for-profit schools have abysmal graduation rates and even worse job placements. If this kind of lending spreads to that industry, there will be substantial negative consequences for students.

### *B. Abuses in Private Student Loans to For-Profit School Students*

Private student loans should be a last resort, something a student enters into only when unable to fund his education through grants and federal loans. Unfortunately, this is not the reality. Some students never exhaust their federal loan limits, but instead go directly into more expensive private loans that do not offer the repayment options available through federal loans.<sup>40</sup> While we can speculate as to why this occurs, one fact is suggestive. The CFPB determined that in 2008, forty-two percent of undergraduate students who attended a for-profit school took out a private loan, while only fourteen percent of all undergraduates had a private student loan.<sup>41</sup> At every stage of the growth and collapse of the private student loan market, for-profit students have originated private loans at a higher percentage than other types of students. At the height of the private student loan boom in 2008, for-profit students were more than three times as likely to have a private student loan than other types of students (11.1% to 39.7%).<sup>42</sup> By 2016, in the aftermath of the collapse of the private student loan market, for-profit students were still over a third more likely than other students to obtain private student loans (7.2% v. 5.3%).<sup>43</sup> This relationship between private student loans and for-profit schools is significant and is the main problem this Article hopes to address.

For-profit schools have used a number of deceptive practices to attract students, many of which involve deceptive student loans. Attorneys general from across the country have brought numerous actions to investigate everything from false advertising to falsifying student signatures on loan applications.<sup>44</sup>

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37. Odinet, *supra* note 6, at 1619–20.

38. *Comparison Tool*, PURDUE U., <https://www.purdue.edu/backaboiler/comparison/index.html> [<https://perma.cc/ZJA2-MCMZ>] (last visited Sept. 27, 2020).

39. *Purdue Graduation Rate & Retention Rates*, COLL. FACTUAL, <https://www.collegefactual.com/colleges/purdue-university-main-campus/academic-life/graduation-and-retention/> [<https://perma.cc/2W8C-6ZZX>] (last visited Sept. 27, 2020).

40. PRIVATE STUDENT LOANS, *supra* note 7, at 4.

41. *Id.*

42. STUDENT BORROWER PROT. CTR., PRIVATE STUDENT LENDING 11 (2020), [https://protectborrowers.org/wp-content/uploads/2020/04/PSL-Report\\_042020.pdf](https://protectborrowers.org/wp-content/uploads/2020/04/PSL-Report_042020.pdf) [<https://perma.cc/GPP2-ZD8A>].

43. *Id.*

44. *See, e.g.*, NAT'L CONSUMER L. CTR., GOVERNMENT INVESTIGATIONS AND LAWSUITS INVOLVING FOR-PROFIT SCHOOLS (2004–May 2014) 2, 12 (2014), <https://www.nclc.org/images/pdf/pr-reports/for-profit-gov-investigations.pdf> [<https://perma.cc/3FUW-2SPW>]. There have been

Unfortunately, the Trump administration, led by Secretary of Education Betsy DeVos, has reduced oversight of for-profit schools and attempted to block states from taking action against bad actors, especially as it relates to federal student loans.<sup>45</sup> Both President Donald Trump and Secretary of Education Betsy DeVos have deep and troubling financial interests in the for-profit education sector.<sup>46</sup> However, there are plenty of reasons for states to become involved when private student loans to for-profit school students are at issue.

### 1. *The 90/10 Rule*

For-profit schools have been the subject of inquiry for decades. The 90/10 rule is the result of multiple federal investigations into fraud and abuse in the for-profit school industry dating back to the 1990s.<sup>47</sup> The rule applies only to for-profit schools. It requires that any higher education institution must derive at least ten percent of its revenue from sources other than federal financial aid, including grants and federally subsidized student loans.<sup>48</sup> The rationale for the rule was that, if the education was worth anything, others besides the federal government would be willing to invest in it.<sup>49</sup> For-profit schools have complained that this law unfairly targets them.<sup>50</sup> It does not apply to either public or nonprofit schools because it does not need to. Research done by the Department of Education shows that public institutions derive twenty-seven percent of their revenue from federal

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other lawsuits since 2014, most notably those brought by the federal government and thirteen attorneys general that forced the closing of Corinthian Colleges.

45. See Danielle Ivory, Erica L. Green & Steve Eder, *Education Department Unwinds Unit Investigating Fraud at For-Profit Schools*, N.Y. TIMES (May 13, 2018), <https://www.nytimes.com/2018/05/13/business/education-department-for-profit-colleges.html> [https://perma.cc/H45P-72MM]; Michael Stratford, *DeVos Escalates Fight with States Over Student Loan Companies*, POLITICO (Sept. 7, 2018, 4:29 PM), <https://www.politico.com/story/2018/09/07/devos-student-loan-companies-774599> [https://perma.cc/QQR4-MD9C].

46. Tom Winter & Dartunorro Clark, *Federal Court Approves \$25 Million Trump University Settlement*, NBC NEWS (Feb. 6, 2018, 12:49 PM), <https://www.nbcnews.com/politics/white-house/federal-court-approves-25-million-trump-university-settlement-n845181> [https://perma.cc/E3N2-HJVE]; Ben Miller & Laura Jimenez, *Inside the Financial Holdings of Billionaire Betsy DeVos*, CTR. FOR AM. PROGRESS (Jan. 27, 2017, 2:24 PM), <https://www.americanprogress.org/issues/education-postsecondary/news/2017/01/27/297572/inside-the-financial-holdings-of-billionaire-betsy-devos/> [https://perma.cc/7PMY-TSTH].

47. VIVIEN LEE & ADAM LOONEY, THE BROOKINGS INST., UNDERSTANDING THE 90/10 RULE: HOW RELIANT ARE PUBLIC, PRIVATE, AND FOR-PROFIT INSTITUTIONS ON FEDERAL AID? 3 (2019), [https://www.brookings.edu/wp-content/uploads/2019/01/ES\\_20190116\\_Looney-90-10.pdf](https://www.brookings.edu/wp-content/uploads/2019/01/ES_20190116_Looney-90-10.pdf) [https://perma.cc/985B-UULZ]. The rule was originally the 85/15 Rule but was subsequently amended to be the 90/10 Rule. Higher Education Amendments of 1992, Pub. L. No. 102-325, 106 Stat. 448, 611, *amended by* Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1581, 1588.

48. § 102, 112 Stat. at 1588.

49. Kelly Field, *Senators Mull Changes in 90/10 Rule to Rein in For-Profits*, CHRON. HIGHER EDUC. (Mar. 2, 2011), <https://www.chronicle.com/article/Senators-Mull-Changes-in-90-10/126564> [https://perma.cc/ESS6-8URB].

50. The Prosper Act, introduced by Representative Foxx of Virginia in 2017, would have repealed the rule. It has not become law, but the idea has not died.

aid and nonprofit institutions derive thirty-nine percent of revenue.<sup>51</sup> For-profit institutions, on the other hand, rely on the federal government for ninety percent of their revenue.<sup>52</sup> This heavy reliance on federal aid has led to abuses by for-profit schools.

Corinthian Colleges have become the poster child for these abuses. In 2014, the CFPB sued Corinthian and a judgment was entered in favor of the CFPB a year later.<sup>53</sup> The complaint outlines how the school used the 90/10 rule to burden their students with predatory private student debt.<sup>54</sup> Corinthian students could not rely on federal student aid for more than ninety percent of the tuition.<sup>55</sup> Therefore, Corinthian raised its tuition so that the maximum allowable federal loans would cover ninety percent of the tuition.<sup>56</sup> The rest would then be covered by private “Genesis” student loans created by and for Corinthian.<sup>57</sup> While the loans were originated by a third party, Corinthian had an obligation to repurchase the loans either immediately or if they became delinquent. More than sixty percent became delinquent. As the CFPB alleged in their complaint, colleges like Corinthian have a strong financial incentive to push these private student loans.<sup>58</sup> Every dollar in private loans they induced a student to incur allowed them to receive an additional nine dollars in Title IV aid.<sup>59</sup>

To fully appreciate how much Corinthian inflated the tuition, a comparison is necessary. In 2013, the cost of a bachelor’s degree at Corinthian Colleges was between \$60,096 and \$75,384.<sup>60</sup> The same degree at Harvard cost slightly less than \$55,000.<sup>61</sup> A similar degree at a state school would cost about \$9,700.<sup>62</sup> No rational person believes that a Corinthian degree has more value than the alternatives. This is a common feature of for-profit education. They charge much higher prices for

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51. LEE & LOONEY, *supra* note 47, at 4.

52. *Id.*

53. CFPB Sues For-Profit Corinthian Colleges for Predatory Lending Scheme, CONSUMER FIN. PROT. BUREAU (Sept. 16, 2014), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-sues-for-profit-corinthian-colleges-for-predatory-lending-scheme/> [https://perma.cc/2QMW-6L36]; CFPB Wins Default Judgment Against Corinthian Colleges for Engaging in a Predatory Lending Scheme, CONSUMER FIN. PROT. BUREAU (Oct. 28, 2015), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-wins-default-judgment-against-corinthian-colleges-for-engaging-in-a-predatory-lending-scheme/> [https://perma.cc/H3NV-MFFC].

54. Complaint at 10, Consumer Fin. Prot. Bureau v. Corinthian Colls., No. 1:14-CV-07194, 2014 WL 5786691 (N.D. Ill. Sept. 16, 2014).

55. *Id.*

56. *Id.*

57. *Id.* at 4.

58. *Id.*

59. *Id.*

60. *Id.* at 8.

61. Frank Olito, *Here’s How the Cost of Harvard Has Changed Throughout the Years*, BUS. INSIDER (June 10, 2019, 8:57 AM), <https://www.businessinsider.com/how-the-cost-of-harvard-has-changed-throughout-the-years2019-6> [https://perma.cc/C7TR-TEPF].

62. COLLEGEBOARD, TRENDS IN COLLEGE PRICING 2019, at 12 (2019) [hereinafter TRENDS], <https://research.collegeboard.org/pdf/trends-college-pricing-2019-full-report.pdf> [https://perma.cc/Z2B4-FN XF].

degrees than comparable public institutions. The Government Accounting Office did an investigation of for-profit schools and discovered significant tuition inflation.<sup>63</sup> Some of the results can be seen in the chart below.

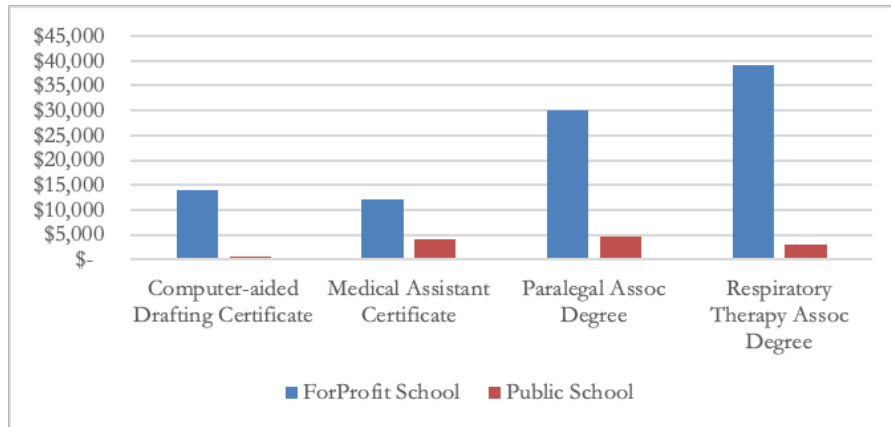


Figure 1: Examples of For-profit versus Public Higher Education Tuition<sup>64</sup>

The for-profit industry has long complained that this 90/10 rule is unfair.<sup>65</sup> The Brookings Institute recently studied the 90/10 rule and found the opposite to be true.<sup>66</sup> According to their investigation, nearly all public (99.9%) and private nonprofit (95.7%) schools comply with the rule.<sup>67</sup> For-profit schools, on the other hand, do not, with nearly twenty percent of the for-profit two-year schools and fifteen percent of the for-profit four-year schools relying on federal dollars for more than ninety percent of their income.<sup>68</sup> Those private nonprofit schools that are failing are doing so primarily because of online and distance learning education.<sup>69</sup> In addition, schools with higher than 90/10 ratios—in other words schools that are relying too much on federal dollars—are of lower quality and have higher student default rates.<sup>70</sup>

An undercover investigation of fifteen online programs at for-profit schools highlighted some of the quality issues for-profit school students face.<sup>71</sup> At one

63. U.S. GOV'T ACCOUNTABILITY OFF., GAO-10-948T, FOR-PROFIT COLLEGES: UNDERCOVER TESTING FINDS COLLEGES ENCOURAGED FRAUD AND ENGAGED IN DECEPTIVE AND QUESTIONABLE MARKETING PRACTICES 18 tbl.3 (2010) [hereinafter GAO-10-948T], <https://www.gao.gov/new.items/d10948t.pdf> [<https://perma.cc/QZV7-8ST8>].

64. *Id.* at 18.

65. *See* LEE & LOONEY, *supra* note 47, at 3.

66. *Id.* at 16.

67. *Id.* at 8 tbl.1.

68. *Id.* at 6 fig.1.

69. *Id.* at 7.

70. *Id.* at 14.

71. U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-150, FOR-PROFIT SCHOOLS: EXPERIENCES OF UNDERCOVER STUDENTS ENROLLED IN ONLINE CLASSES AT SELECTED COLLEGES (2011)

college, for instance, the test student was charged for a laptop when he enrolled.<sup>72</sup> The student told the college he did not want a laptop computer but was told to “fill out the ‘laptop agreement form’ anyway.”<sup>73</sup> The student asked how to return the laptop, but got no reply.<sup>74</sup> Of course, the cost of this unwanted laptop was charged to the student. The testers also documented instances of lax or inconsistent academic standards.<sup>75</sup> Online education poses some of the most significant issues because it is so difficult to monitor. For-profit schools dominate the online education sector.<sup>76</sup> The fundamental problem with for-profit schools is that they simply do not deliver a good product, especially considering its cost.

## 2. Student Outcomes

Studies have shown that people who attend for-profit schools do not fare well in the labor market. In fact, students who attend a for-profit school are more likely to be unemployed, and those who are employed earn less than comparable students who attend public or private nonprofit schools.<sup>77</sup> Corinthian, like many for-profit schools, inflated its job placement statistics to entice students to enroll. The school knew its students had “[m]inimal to nonexistent understanding of basic financial concepts,” making them the perfect target for predatory loan products.<sup>78</sup>

Many students who enroll in for-profit schools are first-generation college students.<sup>79</sup> They are more likely to be poor and more likely to be minorities.<sup>80</sup> Communities of color “are more likely to experience delinquency or default.”<sup>81</sup> In fact, ten percent of all black undergraduates attend a for-profit schools.<sup>82</sup> All these factors made these students very vulnerable to abuse. The students are trying to do what they had been told to do to be successful, get a college education. Instead, they ended up with a nearly worthless degree and massive student debt—if they graduated at all. In 2017, the six-year graduation rate (the number of students who

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[hereinafter GAO-12-150], <https://www.gao.gov/assets/590/586456.pdf> [https://perma.cc/H86W-J3LT].

72. *Id.* at 9.

73. *Id.*

74. *Id.*

75. *Id.* at 7.

76. *See infra* Section II.B.2.

77. CAREN A. ARBEIT & LAURA HORN, NAT’L CTR. FOR EDUC. STAT., A PROFILE OF THE ENROLLMENT PATTERNS AND DEMOGRAPHIC CHARACTERISTICS OF UNDERGRADUATES AT FOR-PROFIT INSTITUTIONS 3 (2017), <https://nces.ed.gov/pubs2017/2017416.pdf> [https://perma.cc/EJT7-E3XJ].

78. Complaint, *supra* note 54, at 3.

79. ARBEIT & HORN, *supra* note 77, at 11.

80. Aissa Canchola & Seth Frotman, *The Significant Impact of Student Debt on Communities of Color*, Blog for CONSUMER FIN. PROT. BUREAU (Sept. 15, 2016), <https://www.consumerfinance.gov/about-us/blog/significant-impact-student-debt-communities-color/> [https://perma.cc/GU66-QZP9].

81. *Id.*

82. TRENDS, *supra* note 62, at 32 fig.23A.

began their education in 2011 and completed it by 2017) at for-profit schools was only twenty-one percent.<sup>83</sup>

For-profit institutions market heavily to military students. As a result, “[m]ilitary students constitute[] a larger percentage of students in for-profit four-year institutions than in all other institutions.”<sup>84</sup> Military students bring unique financial benefits to for-profit schools. The federal government has enacted a number of programs that will pay for educational programs for both active duty soldiers and veterans.<sup>85</sup> This is especially attractive to for-profit schools because these federal funds are not counted in the ninety percent for purposes of the 90/10 rule.<sup>86</sup> As a result, a veteran has used his or her entire GI benefit at a for-profit school only to discover the degree is worthless.<sup>87</sup> This is more insidious when considered in combination with the heavy marketing done by the military to entice usually low-income minority enlistees with the hope of a free college education. Even as civilian enrollment in for-profit colleges declined, military enrollment increased.<sup>88</sup> The University of Phoenix alone enrolled 50,000 veterans after the Iraq and Afghanistan deployments, earning \$345 million in federal benefits.<sup>89</sup>

We traditionally think of college students as young, recent graduates from high school. For the most part, they are.<sup>90</sup> However, many older Americans have been encouraged—especially after the Great Recession—to go back to school to become better able to earn a living in the modern economy. Higher education is no longer seen as a broad opportunity to gain knowledge. It is viewed as being directly connected to your future earning potential. Older students are more likely to attend a for-profit institution.<sup>91</sup> As a result, when labor markets decrease, enrollment in local for-profit schools increases.<sup>92</sup> This makes sense, especially for older students who may have family obligations that do not permit them to attend schools farther from home. Lower-income students also attend in larger numbers, probably for similar reasons. Unfortunately, most students who attend a for-profit college are

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83. *Fast Facts*, NAT’L CTR. FOR EDUC. STAT., <https://nces.ed.gov/fastfacts/display.asp?id=40> [<https://perma.cc/FH2K-BYJ4>] (last visited Sept. 27, 2020).

84. ARBEIT & HORN, *supra* note 77, at 6, 16.

85. Christopher J. Salemme, *Unpatriotic Profit: How For-Profit Colleges Target Veterans and What the Government Must Do to Stop Them*, 32 *BYU J. PUB. L.* 89, 98–99 (2017).

86. *Id.* at 101.

87. *Id.* at 89–90.

88. *Id.* at 91.

89. *Id.*

90. During the 2011–2012 academic year, 56.2% of all undergraduates were twenty-three or younger. ARBEIT & HORN, *supra* note 77, at 12 tbl.2.

91. *Id.* at 2.

92. See Luis Armona, Rajashri Chakrabarti & Michael F. Lovenheim, *How Does For-Profit College Attendance Affect Student Loans, Defaults, and Labor Market Outcomes?* 24 (EconStor, Working Paper No. 811, 2017), <https://www.econstor.eu/handle/10419/189852> [<https://perma.cc/R4AW-K5W4>].

worse off. They do not get the promised increase in income and they leave with a mountain of debt.<sup>93</sup>

### 3. Deceptive Advertisement and Lead Generators

The Government Accounting Office has conducted extensive investigations of for-profit schools.<sup>94</sup> In one of its investigations, undercover testers were sent to fifteen for-profit colleges and found fraudulent practices related to the FAFSA application in nearly a third.<sup>95</sup> Several schools were encouraging students to falsify their FAFSA applications to qualify for more aid than they were legally eligible to receive.<sup>96</sup> Several of the schools refused to even discuss financial aid until they committed to enrollment.<sup>97</sup> More significantly, all fifteen schools engaged in deceptive, even fraudulent, statements related to their accreditation, job prospects, and graduation rates.<sup>98</sup>

Inflated and often fraudulent representations about job prospects and earning potential are among the most common questionable practices of for-profit schools. The research clearly documents that attending a for-profit school does not lead to the career advancements promised.<sup>99</sup> This has not stopped the industry from claiming otherwise. Students were given false information about the employment success of its students. DeVry promised ninety percent employment in a student's respective field.<sup>100</sup> When the Federal Trade Commission (FTC) investigated, it found that the reality did not match the marketing.<sup>101</sup> DeVry had a very loose—the FTC would say deceptive—way of measuring employment in the field.<sup>102</sup> For example, one student with a degree in administration was working as a waiter and another with a degree in technical management was a clerk in a department store.<sup>103</sup> While DeVry denied the allegation in its settlement with the FTC, a look at its most recent employment disclosures shows a more realistic picture of its graduate

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93. Stephanie Riegg Cellini & Nicolas Turner, *Gainfully Employed? Assessing the Employment and Earnings of For-Profit College Students Using Administrative Data* 26 (Nat'l Bureau of Econ. Rsch., Working Paper No. 2287, 2016, revised 2018), <https://www.nber.org/papers/w22287.pdf> [<https://perma.cc/47CZ-Q4AD>].

94. See, e.g., GAO-10-948T, *supra* note 63; GAO-12-150, *supra* note 71.

95. GAO-10-948T, *supra* note 63, at 7.

96. *Id.* at 8 tbl.1.

97. *Id.* at 11.

98. *Id.* at 9.

99. See Cellini & Turner, *supra* note 93.

100. Michael Vasquez, *DeVry U. Accused of Using Phony Job Placement Rates*, MIAMI HERALD (Jan. 27, 2016, 9:56 PM), <https://www.miamiherald.com/news/local/education/article56933743.html> [<https://perma.cc/GNQ2-MN3P>].

101. *Id.*

102. *Id.*

103. *Id.*; Lesley Fair, *FTC Case Against DeVry Yields \$100 Million Settlement*, FED. TRADE COMM'N (Dec. 15, 2016, 11:59 AM), <https://www.ftc.gov/news-events/blogs/business-blog/2016/12/ftc-case-against-devry-yields-100-million-settlement?page=2> [<https://perma.cc/638S-JVL8>].

outcomes. Very few of its graduates are finding jobs in their field of study.<sup>104</sup> In most cases, no one was employed and in a vast number of categories, fewer than one quarter of the students had found employment in their field of study.<sup>105</sup>

University of Phoenix is part of the Apollo Education Group, one of the largest for-profit conglomerates.<sup>106</sup> It recently settled a similar action brought by the Federal Trade Commission involving this kind of deceptive advertising practice.<sup>107</sup> Unlike DeVry, University of Phoenix was not claiming certain employment numbers, just outcomes. University of Phoenix's ad campaign featured companies like Twitter, Microsoft, Adobe, and Yahoo, leaving the viewer with the impression that its graduates worked for these companies.<sup>108</sup> They did not.<sup>109</sup> These are just a few examples of what has been a common practice in the industry: luring students with false claims of employment and financial success.

Aggressive recruiting tactics that misrepresent the program itself have been another common practice in this industry. Attorneys general from numerous states, later joined by the federal government, sued Education Management Corporation (EMC) alleging, among other things, that it paid its recruiters bonuses in violation of federal law based on the number of students they enrolled.<sup>110</sup> In addition, the schools offered certificates in fields when their programs were not accredited. Brown Mackie, an EMC school with locations in South Bend, Indiana, offered a radiology technology certification. The Notre Dame Clinical Law Center had numerous clients who acquired student loan debt to complete this degree. Unfortunately, the program was not accredited, and despite a need for such employees in the area, students who completed the course could not find employment.

The Obama administration took action to curb these particular abuses when it enacted the gainful employment rule.<sup>111</sup> In order to be eligible for federal student loan funds, schools were required to document that their programs met certification

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104. DEVRY UNIVERSITY EMPLOYMENT OUTCOME DISCLOSURES (2020), <https://www.devry.edu/d/graduate-employment-outcomes.pdf> [https://perma.cc/HUP7-ULDJ].

105. *Id.*

106. Vicente M. Lechuga, *Who Are They? And What Do They Do?*, in FOR-PROFIT COLLEGES AND UNIVERSITIES: THEIR MARKETS, REGULATION, PERFORMANCE, AND PLACE IN HIGHER EDUCATION 47, 51 (Guilbert C. Hentschke, Vicente M. Lechuga & William G. Tierney eds., 2010).

107. Danielle Douglas-Gabriel, *FTC Reaches \$191 Million Settlement with University of Phoenix in Deceptive-Advertising Probe*, WASH. POST (Dec. 10, 2019, 10:44 AM), <https://www.washingtonpost.com/education/2019/12/10/ftc-reaches-million-settlement-with-university-phoenix-deceptive-advertising-probe/> [https://perma.cc/TNX7-9DCW].

108. *Id.*

109. Cellini & Turner, *supra* note 93.

110. Stephanie Saul, *For-Profit College Operator EDMC Will Forgive Student Loans*, N.Y. TIMES (Nov. 16, 2015), <https://www.nytimes.com/2015/11/17/us/for-profit-college-operator-edmc-will-forgive-student-loans.html> [https://perma.cc/FCB3-DGUY].

111. 34 C.F.R. § 600 (1994); Press Release, U.S. Dep't of Educ., Obama Administration Announces Final Rules to Protect Students from Poor-Performing College Programs (Oct. 30, 2014), <https://www.ed.gov/news/press-releases/obama-administration-announces-final-rules-protect-students-poor-performing-career-college-programs> [https://perma.cc/2MGL-957X].



requirements and that a certain minimum number of their graduates found gainful employment.<sup>112</sup> Secretary of Education Betsy DeVos and the Trump administration moved swiftly to protect their personal interests in the for-profit school market and repealed the gainful employment rule.<sup>113</sup> Then, with virtually no pre-warning, the Department of Education changed its policies and announced it would no longer disclose records to law enforcement agencies.<sup>114</sup> Attorneys general objected strenuously. Only by obtaining this information could attorneys general fulfill their role to protect the “nation’s student loan borrowers from unfair, deceptive, and predatory practices in the higher education field, as well as state regulators’ roles in licensing and supervising schools.”<sup>115</sup> Clearly, Ms. DeVos is more interested in protecting the for-profit industry from the prying eyes of investigators than providing the attorneys general the information needed to protect students.

Another troubling aspect of the industry is its use of lead generators to recruit students. The Federal Trade Commission recently took action against two such companies, Sunkey Publishing, Inc. and Fanmail.com, LLC.<sup>116</sup> These companies created websites with names like navyenlist.com and armyenlist.com, which they populated with pictures of military men and women. Site visitors were asked to complete a “U.S. Army Information Request” with their name and other relevant information, as if they were applying to enlist.<sup>117</sup> Instead, their information was sent to for-profit schools who informed them that the military really wanted to enlist them, but they needed a college degree first.<sup>118</sup> Students were told not to worry about the costs, the school would lend the money.<sup>119</sup> Through this fraudulent

112. 34 C.F.R. § 668.403 (2014).

113. David Whitman & Arne Duncan, *Betsy DeVos and Her Cone of Silence on For-Profit Colleges*, BROOKINGS (Oct. 17, 2018), <https://www.brookings.edu/research/betsy-devos-for-profit-colleges-education-america/> [https://perma.cc/BE9N-6VUF]; Diana Hembree, *Investigations into For-Profit College Abuses Dismantles Under Betsy DeVos*, FORBES (May 14, 2018, 4:18 PM), <https://www.forbes.com/sites/dianahembree/2018/05/14/education-department-dismantles-team-that-investigated-for-profit-college-abuses/#d2977747ce0a> [https://perma.cc/HP5K-RV9V].

114. Privacy Act of 1974, Pub. L. No. 93-579, 88 Stat. 1896; System of Records, 83 Fed. Reg. 27587, 27588 (June 13, 2018).

115. Letter from Gurbir S. Grewal, Bob Ferguson, Xavier Becerra, Cynthia H. Coffman, George Jepsen, Matthew P. Denn, Karl A. Racine, Russell A. Suzuki, Lisa Madigan, Thomas J. Miller, Janet T. Mills, Brian E. Frosh, Maura Healey, Lori Swanson, Barbara D. Underwood, Joshua H. Stein, Ellen F. Rosenblum, Josh Shapiro, Peter F. Kilmartin & Mark R. Herring, Att’ys Gen. of New Jersey, Washington, California, Colorado, Connecticut, Delaware, District of Columbia, Hawai’i, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, New York, North Carolina, Oregon, Pennsylvania, Rhode Island & Virginia, to Betsy DeVos, Sec’y, U.S. Dep’t of Educ. (July 13, 2018), [https://ag.ny.gov/sites/default/files/final\\_nj\\_wa\\_privacy\\_act\\_letter\\_7.13.18.pdf](https://ag.ny.gov/sites/default/files/final_nj_wa_privacy_act_letter_7.13.18.pdf) [https://perma.cc/46KQ-SPZ4].

116. Press Release, Fed. Trade Comm’n, FTC Takes Action Against the Operators of Copycat Military Websites (Sept. 6, 2018), <https://www.ftc.gov/news-events/press-releases/2018/09/ftc-takes-action-against-operators-copycat-military-websites> [https://perma.cc/UJ4T-53W6].

117. *Id.*

118. *Id.*

119. Complaint for Civil Penalties, Permanent Injunction, and Other Equitable Relief at 35, *United States v. Sunkey Publ’g, Inc.*, No. 3:18-cv-01444, 2018 WL 4282853 (N.D. Ala. Sept. 6, 2018).

scheme, many young men and women who had hoped to enlist in the military were instead steered to for-profit schools where they were enrolled in effectively useless programs that did nothing to improve their chance of enlistment. In fact, for many it hurt them in achieving their goal. Debt is considered a security risk and a proposed enlistee with too much debt will not be eligible for certain security clearances, barring certain career paths.<sup>120</sup>

In a similar case, the FTC brought an enforcement action against several for-profit schools and their lead generators for setting up fraudulent websites that looked like job postings.<sup>121</sup> The websites would trick people into providing their names and other personal information, allegedly as a means to applying for a job.<sup>122</sup> Instead, the information was passed on to for-profit schools who used aggressive marketing techniques to convince these vulnerable people looking for a job that the way to become employed is to enroll in a for-profit school and take out thousands of dollars in loans.<sup>123</sup>

#### 4. Servicing Abuses

Regardless of who originates a student loan, the federal government or a financial institution, a student loan is more likely than not to be serviced by a third party. Currently, three servicers dominate the industry: Navient (formerly Sallie Mae), Nelnet, and AES/Federal Loan Servicing.<sup>124</sup> More than 13,000 complaints have been lodged with the CFPB regarding private student loans, many regarding servicing issues.<sup>125</sup> NerdWallet analyzed the 2015 CFPB complaints and revealed that dealing with the servicer was the most common reason for filing a complaint.<sup>126</sup> In 2015, the CFPB issued a “Request for Information Regarding Student Loan

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120. See, e.g., 10 C.F.R. § 710 app. A (2020) (“Failure to live with one’s means, satisfy debts, and meet financial obligations may indicate poor self-control, lack of judgment, or unwillingness to abide by rules and regulations, all of which can raise questions about an individual’s reliability, trustworthiness, and ability to protect classified or sensitive information.”).

121. Lesley Fair, *Settlement with Operator of Post-Secondary Schools Offer an Education About Lead Generation*, FED. TRADE COMM’N (Aug. 27, 2019, 11:55 AM), <https://www.ftc.gov/news-events/blogs/business-blog/2019/08/settlement-operator-post-secondary-schools-offers-education> [<https://perma.cc/3UXK-63V3>].

122. *Id.*

123. *Id.*

124. Matt Carter, ‘Big Four’ Student Loan Servicers Now ‘Big Three,’ CREDIBLE (Feb. 8, 2018), <https://www.credible.com/news/student-loans/big-four-student-loan-servicers-now-three/> [<https://perma.cc/QBB7-9999>].

125. *Consumer Complaint Database*, CONSUMER FIN. PROT. BUREAU, [https://www.consumerfinance.gov/data-research/consumer-complaints/search/?dataNormalization=None&dateRange=All&date\\_received\\_max=2020-10-04&date\\_received\\_min=2011-12-01&searchField=all&searchText=privatestudentloan&tab=Map](https://www.consumerfinance.gov/data-research/consumer-complaints/search/?dataNormalization=None&dateRange=All&date_received_max=2020-10-04&date_received_min=2011-12-01&searchField=all&searchText=privatestudentloan&tab=Map) [<https://perma.cc/72H6-HHFP>] (last visited Sept. 27, 2020).

126. Victoria Simons & Anna Helhoski, *Thousands of Grads File Complaints About Dealing with Private Student Loan Companies*, NERDWALLET: LOANS BLOG (Apr. 5, 2016), <https://www.nerdwallet.com/blog/loans/student-loans/student-loan-cfpb-complaints/> [<https://perma.cc/P38F-V48U>].

Servicing” and received more than 7,000 responses.<sup>127</sup> Many of the comments documented servicing abuses and errors.<sup>128</sup> Things have not improved since that time.

The CFPB has taken action against several servicers for their practices in servicing both federal and private student loans. In an action against Wells Fargo Bank, the CFPB alleged the bank was engaged in illegal private student loan servicing practices that increased costs and unfairly penalized certain loan borrowers.<sup>129</sup> The unfair and unlawful practices engaged in by Wells Fargo included “failing to provide important payment information to consumers, charging consumers illegal fees, and failing to update inaccurate credit report information.”<sup>130</sup> Ultimately, Wells Fargo was ordered to improve its student loan servicing practices, in particular the application of partial payments, which the CFPB believed would reduce the number of delinquent loans as well as the number of late fees.<sup>131</sup> In 2017, the CFPB took similar action against Navient. While some of the issues in the complaint only pertain to federal loans, Navient has shown a pattern of activity that impacts the private loans it services as well.<sup>132</sup>

Absent a meaningful stake in a loan’s performance, student loan servicing industry creates a similar principal-agent conflict that was seen during the mortgage crisis in which servicers’ incentives diverge from that of investors.<sup>133</sup> The market was unable to “self-correct because neither [the mortgage] investors nor affected homeowners ha[d] the incentives or the bargaining power to fix the system.”<sup>134</sup>

As a group, student loan borrowers are even more vulnerable. They are disproportionately underrepresented and need better consumer protections. In fact, “research suggests higher rates of student loan defaults and delinquencies in ZIP codes populated primarily by minorities with higher income levels.”<sup>135</sup> These

127. 80 Fed. Reg. 29302 (May 21, 2015); *CFPB Publishes Over 7,700 Consumer Complaint Narratives About Financial Companies*, CONSUMER FIN. PROT. BUREAU (June 25, 2015), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-publishes-over-7700-consumer-complaint-narratives-about-financial-companies/> [<https://perma.cc/JSE4-RFYP>].

128. *Request for Information Regarding Student Loan Servicing*, REGULATIONS.GOV, <https://www.regulations.gov/docketBrowser?rpp=50&so=DESC&sb=postedDate&po=0&dct=PS&D=CFPB-2015-0021> [<https://perma.cc/GQE9-HTWN>] (last visited Sept. 27, 2020) (Docket ID No. CFPB-2015-0021).

129. *CFPB Takes Action Against Wells Fargo for Loan Servicing Practices*, CONSUMER FIN. PROT. BUREAU (Aug. 22, 2016) [hereinafter *CFPB Action*], <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-wells-fargo-illegal-student-loan-servicing-practices/> [<https://perma.cc/S3S4-946B>].

130. *Id.* See generally Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0013 (Aug. 22, 2016), [https://files.consumerfinance.gov/f/documents/2016-CFPB-0013Wells\\_Fargo\\_Bank\\_N.A.--\\_Consent\\_Order.pdf](https://files.consumerfinance.gov/f/documents/2016-CFPB-0013Wells_Fargo_Bank_N.A.--_Consent_Order.pdf) [<https://perma.cc/FAT9-PX2W>].

131. *CFPB Action*, *supra* note 129.

132. Complaint, Consumer Fin. Prot. Bureau v. Navient Corp., No. 3:17-cv-00101-RDM, 2017 WL 191446 (M.D. Pa. Jan. 18, 2017).

133. Adam Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REGUL. 1, 69 (2011), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1324023](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1324023) [<https://perma.cc/6WEN-URGD>].

134. *Id.*

135. Canchola & Frotman, *supra* note 80.

statistics “raise concerns that millions of borrowers may not be getting information about repayment options or may encounter breakdowns when attempting to enroll in these plans.”<sup>136</sup>

As mentioned previously, for-profit schools aggressively market to military students and, as a result, have a disproportionate number of military borrowers. When a servicemember is on active duty, he or she is eligible for an interest rate reduction to six percent.<sup>137</sup> Servicers have also illegally required active duty military personnel to reapply or update the loan servicer periodically in order to maintain the interest rate deduction.<sup>138</sup> A servicemember in a war zone certainly does not have access to the documentation being demanded by the servicer. The servicers create unnecessary, and often illegal, hurdles to prevent servicemembers from accessing the rights federal law affords them.<sup>139</sup>

### *C. Lack of Rights Under Existing Law*

For-profit school borrowers with private student loans face a unique lack of rights under federal and state law. Section I.C.1 discusses the difference between the rights given to borrowers of federal student loans versus the limited rights and resources available for private student loan borrowers. Section I.C.2 places this relative difference in the context of the bankruptcy discharge exception faced by all student loan borrowers.

#### *1. Private Student Loan Borrowers Lack Protections Afforded to Federal Student Loan Borrowers*

For federal student loan borrowers, the obstacles to discharge debt in bankruptcy are counterbalanced by a panoply of rights. Private student loan borrowers have no such protections.

##### *a. Federal Student Loan Repayment and Discharge Rights*

The federal student loan program has evolved to provide borrowers a broad set of protections designed to ensure that the loans are affordable and repayment is fair under the borrower’s life circumstances. We describe these rights below in four categories: repayment rights, disability discharge, school-related discharge, and public service discharge.

*Repayment rights* are provided to federal student loan borrowers who can select among a variety of loan terms and repayment schedules, although options depend on the amount of the loan and the federal loan program under which the money

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136. *Id.*

137. Servicemembers Civil Relief Act, 50 U.S.C. § 3937.

138. HOLLISTER PETRAEUS & ROHIT CHOPRA, CONSUMER FIN. PROT. BUREAU, THE NEXT FRONT? STUDENT LOAN SERVICING AND THE COST TO OUR MEN AND WOMEN IN UNIFORM 7 (2012), [https://files.consumerfinance.gov/f/201210\\_cfpb\\_servicemember-student-loan-servicing.pdf](https://files.consumerfinance.gov/f/201210_cfpb_servicemember-student-loan-servicing.pdf) [<https://perma.cc/7RKU-W8YF>].

139. *Id.*

was borrowed.<sup>140</sup> Most importantly, federal student loan borrowers have the option to participate in a variety of income-driven repayment plans, depending on when the loan was originated or disbursed.<sup>141</sup> For example, student borrowers in the Pay As You Earn (PAYE) program pay ten percent of discretionary income or less, and their loans are forgiven after twenty years of qualifying payments.<sup>142</sup> Income-driven plans are designed for the purpose of making student loan payments affordable regardless of the student's earnings after leaving school.<sup>143</sup>

The federal student loan program offers a variety of other rights for the repayment of loans that are not typical of consumer credit contracts. Federal student loans are not declared in default until after 270 days of nonpayment.<sup>144</sup> To forestall default, federal student loan borrowers can invoke rights to forbear on payment or defer repayment.<sup>145</sup> Even after default, borrowers have a onetime right to "consolidate" loans or a right to "rehabilitate" their loan status by making nine months of payments in a specified amount.<sup>146</sup> And as noted above, the cost of the loans also are a benefit, with interest rates much lower than private loans and interest accumulating only upon leaving school.

Federal law allows discharge of federal student loan obligations for three categories of events: disability, school-related, and public service. *Disability discharge* is available to student loan borrowers who become totally and permanently disabled.<sup>147</sup> Borrowers meeting the disability standard are subject to a review of

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140. NAT'L CONSUMER L. CTR., STUDENT LOAN LAW § 3.2 (6th ed. 2019).

141. *Id.* § 3.3.1.

142. *Id.* The repayment history necessary to obtain forgiveness can be met under any one of numerous criteria. *Id.* § 3.3.3.8.

143. John R. Brooks, *The Case for More Debt: Expanding College Affordability by Expanding Income-Driven Repayment*, 2018 UTAH L. REV. 847, 847 (2018) ("At its core, the promise of IDR is that higher education will always be affordable, no matter what a person's income is after the person leaves school.").

144. NAT'L CONSUMER L. CTR., *supra* note 140, § 6.2.1.

145. NAT'L CONSUMER L. CTR., *supra* note 140, § 4.4. Forbearance, however, has been misused by servicers of federal student loans as a profitable catch-all response to repayment distress even when students could have exercised IDR or other more appropriate repayment rights. Complaint, Consumer Fin. Prot. Bureau v. Navient Corp., No. 3:17-cv-00101-RDM, 2017 WL 191446 (M.D. Pa. Jan. 18, 2017) (alleging that Navient steers borrowers into forbearance instead of options in the best interests of borrowers).

146. NAT'L CONSUMER L. CTR., *supra* note 140, §§ 7.2–.3.

147. 20 U.S.C. § 1087. The ED regulations mirror the statutory requirements, providing for disability discharge when the borrower "(1) Is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that—(i) Can be expected to result in death; (ii) Has lasted for a continuous period of not less than 60 months; or (iii) Can be expected to last for a continuous period of not less than 60 months; or (2) Has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected disability," and defining "substantial gainful activity" as "[a] level of work performed for pay or profit that involves doing significant physical or mental activities, or a combination of both." 34 C.F.R. § 685.102 (2020) (applicable to direct loans).

income during the succeeding three years to verify continued disability.<sup>148</sup> Federal student loans are discharged on death of the borrower.<sup>149</sup>

*School-related discharge* is available if the school closes prior to the borrower's completion of the program or if the school made a false certification to the appropriate higher education certification authority.<sup>150</sup> False certification discharge is available under Department of Education (ED) regulations based on falsely certifying a non-high school graduate for a loan, forgery or identity theft, or certifying "the eligibility of the student who, because of a physical or mental condition, age, criminal record, or other reason accepted by the Secretary, would not meet State requirements for employment . . . in the occupation for which the training program supported by the loan was intended."<sup>151</sup> School-related discharges generally are not automatic but rather require an application for discharge be filed by the student borrower and approved by the ED.<sup>152</sup>

Another right of federal student loan borrowers that we categorize as a form of school-related discharge is administrative loan cancellation by the ED due to school misconduct, which is commonly referred to as "borrower defense." A borrower can present a defense to federal student loan repayment based on failure by the school to perform contractual obligations or the school engaged in a "substantial misrepresentation."<sup>153</sup> The ED promulgated a new rule related to borrower defense in 2016, but the Trump administration under Secretary of Education Betsy DeVos attempted to delay the implementation of the rule. A federal court vacated this action, thus leaving the rule in effect, but the end result has been confusion as to the use of the borrower defense rule.<sup>154</sup>

Finally, *public service discharge* is available to student borrowers entering certain professions. The Public Service Loan Forgiveness (PSLF) program, enacted in 2007,

148. NAT'L CONSUMER L. CTR., *supra* note 140, § 10.8.2 (describing three-year period and history of disability discharge process).

149. 20 U.S.C. § 1087.

150. NAT'L CONSUMER L. CTR., *supra* note 140, § 10.3.1 (closed school discharge); *id.* § 10.4.1 (false certification). Federal student loan borrowers also can discharge loans based on unpaid refunds by the school. *Id.* § 10.5.1.

151. 34 C.F.R. § 685.215(a)(iv) (2020) (direct loans). Higher education institutions can certify a student's "ability to benefit" in lieu of a high school diploma to qualify the student for federal funding. 20 U.S.C. § 1091(d)(1)(A)(ii). Discharge is available for students who falsely certified under this criterion. 34 C.F.R. § 685.215(a)(1)(i)(B) (2020). Borrowers under the discontinued FFEL program had analogous rights. 78 Fed. Reg. 65768, 65768 (Nov. 1, 2013).

152. *If Your School Closes While You're Enrolled or Soon After You Withdraw, You May Be Eligible for Discharge of Your Federal Student Loan*, FED. STUDENT AID, <https://studentaid.gov/manage-loans/forgiveness-cancellation/closed-school> [https://perma.cc/652T-WV5B] (last visited Sept. 27, 2020); *You Might Be Eligible for a Discharge of Your Federal Student Loans Based on False Certification*, FED. STUDENT AID, <https://studentaid.gov/manage-loans/forgiveness-cancellation/false-certification> [https://perma.cc/5XST-8YV6] (last visited Sept. 27, 2020).

153. NAT'L CONSUMER L. CTR., *supra* note 140, §§ 10.6.1, .2.3 (describing the development and limits of the borrower defense rule).

154. 34 C.F.R. § 685.222 (2020) (explaining ED regulations pertaining to direct loans disbursed after June 2017); *Bauer v. DeVos*, 332 F. Supp. 3d 181 (D.D.C. 2018); *see* NAT'L CONSUMER L. CTR., *supra* note 140, § 10.

allows student borrowers working for a public service employer and making income-driven repayment (IDR) payments to discharge the debt after ten years, rather than waiting the twenty or twenty-five years typically required for discharge with IDR.<sup>155</sup> Careers eligible for PSLF discharge include those that “traditionally feature more modest wages, relative to many private sector fields that require comparable levels of advanced education,” with “nearly two thirds (62 percent) of borrowers who have certified intent to pursue PSLF reported earning less than \$50,000 per year.”<sup>156</sup> Similarly, college graduates who teach in certain low-income schools can receive up to \$17,500 in loan forgiveness,<sup>157</sup> and there are other targeted federal and state loan forgiveness programs based on service in professions with public benefit.<sup>158</sup>

Disability, closed school, false certification, and PSLF discharge result in full debt cancellation, while a successful borrower defense application can result in a partial cancellation of the remaining debt.<sup>159</sup> Federal student loan borrowers can use all of these repayment and discharge rights to which they are entitled; they are not mutually exclusive.<sup>160</sup> It is important to note that the existence of these federal rights is a different matter than effective implementation of these rights. The ED and its contracted servicers have been severely and repeatedly criticized for failing to properly implement, or actively obstructing borrower use of, these rights.<sup>161</sup>

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155. 20 U.S.C. § 1087e(m); 34 C.F.R. § 685.219 (2020).

156. CONSUMER FIN. PROT. BUREAU, STAYING ON TRACK WHILE GIVING BACK: THE COST OF STUDENT LOAN SERVICING BREAKDOWNS FOR PEOPLE SERVING THEIR COMMUNITIES 7, 21 (2017) [hereinafter CFPB 2017 REPORT], [https://files.consumerfinance.gov/f/documents/201706\\_cfpb\\_PSLF-midyear-report.pdf](https://files.consumerfinance.gov/f/documents/201706_cfpb_PSLF-midyear-report.pdf) [<https://perma.cc/Y2X4-T7MJ>].

157. NAT’L CONSUMER L. CTR., *supra* note 140, § 10.11.

158. *Id.* §§ 10.12–13; *see, e.g.*, Richard P. Eckman, Albert H. Manwaring IV & Kelly R. Bryan, *Heroes Act Gives Loan Relief to Reservists on Active Duty*, 58 CONSUMER FIN. L.Q. REP. 205 (2004) (describing student loan relief available to U.S. military reservists who are called to active duty, those working disaster areas, and other similar groups).

159. NAT’L CONSUMER L. CTR., *supra* note 140, § 10.7.

160. One potential downside of federal student loan discharge rights is that many loan discharges currently result in an attribution of taxable income for the cancellation of the debt. NAT’L CONSUMER L. CTR., *supra* note 140, § 10.15.1.

161. First, in the realm of disability discharge there are multiple examples of this failure. U.S. GOV’T ACCOUNTABILITY OFF., GAO-17-45, SOCIAL SECURITY OFFSETS: IMPROVEMENTS TO PROGRAM DESIGN COULD BETTER ASSIST OLDER STUDENT LOAN BORROWERS WITH OBTAINING PERMITTED RELIEF (2016); Letter from Chris Coons, Rob Portman & Angus King, U.S. Sens., to Betsy DeVos, Sec’y of Educ., U.S. Dep’t of Educ., David Shulkin, Sec’y of Veteran Affs., U.S. Dep’t of Veteran Affs. & Nancy Berryhill, Acting Comm’r of Soc. Sec., U.S. Soc. Sec. Admin. (Feb. 15, 2018), <https://www.coons.senate.gov/news/press-releases/with-new-tax-law-in-place-sens-coons-king-portman-urge-trump-administration-to-discharge-outstanding-federal-student-loans-for-totally-and-permanently-disabled-americans> [<https://perma.cc/24N4-XS5D>]; Clare Lombardo & Cory Turner, *Student Loan Borrowers with Disabilities Aren’t Getting Help They Were Promised*, NPR (Dec. 4, 2019, 5:00 AM), <https://www.npr.org/2019/12/04/776058798/why-student-loan-borrowers-with-disabilities-arent-getting-the-help-they-deserve> [<https://perma.cc/L5VS-XZCL>]. This failure is evident in the public service context as well. U.S. GOV’T ACCOUNTABILITY OFF., GAO-18-547, PUBLIC SERVICE LOAN FORGIVENESS: EDUCATION NEEDS TO PROVIDE BETTER INFORMATION FOR THE LOAN SERVICER AND BORROWERS (2018) (reporting only 55 of 19,321 applicants were granted a PSLF discharge of remaining student loan obligations because of ED administrative obstacles); U.S. GOV’T

*b. Private Student Loan Borrowers Lack Analogous Rights*

The borrower defense rule substantially aligns with the protections afforded to private student loan borrowers under the FTC Holder Rule, as discussed in Part II.<sup>162</sup> Other than this exception, private student loan borrowers have no analogous rights under federal or state law to the plethora of repayment or discharge protections afforded to federal student loan borrowers.

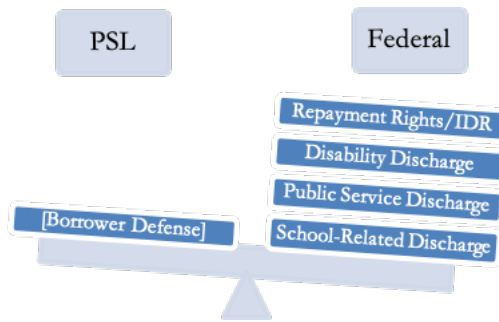


Figure 2: Lack of Protections for Private Student Loan Borrowers

For the most part, private student loan lenders are bound only by general commercial law, including the law of contracts and tort, unfair and deceptive acts and practices (UDAP) law, and the like. Depending on the contract terms, lenders can declare private student loan borrowers in default after one missed payment or even impose universal default clauses that allow debt acceleration and collection even when the borrower is current on payments.<sup>163</sup> The National Consumer Law

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ACCOUNTABILITY OFF., GAO-19-595, PUBLIC SERVICE LOAN FORGIVENESS: IMPROVING THE TEMPORARY EXPANDED PROCESS COULD HELP REDUCE BORROWER CONFUSION (2019) (reporting that ED again rejected ninety-nine percent of PSLF applicants after Congressional temporary extension of program due to prior mass denials); CFPB 2017 REPORT, *supra* note 156, at 33 (detailing examples of servicing misconduct in PSLF program); Adam Minsky, *What It's like to Apply for Public Service Loan Forgiveness*, FORBES (Aug. 13, 2019, 12:19 PM), <https://www.forbes.com/sites/adamminsky/2019/08/13/what-its-like-to-apply-for-public-service-loan-forgiveness> [<https://perma.cc/D265-BKV3>] (providing an example of how the ED servicing process stymies obtaining PSLF discharge); Cory Turner & Chris Arnold, *Dept. of Education Fail: Teachers Lose Grants, Forced to Repay Thousands in Loans*, NPR (Mar. 28, 2018, 5:01 AM), <https://www.npr.org/sections/ed/2018/03/28/596162853/dept-of-education-fail-teachers-lose-grants-forced-to-repay-thousands-in-loans> [<https://perma.cc/9VWY-KKFS>]. The failure is also present in terms of income-driven repayment. CFPB 2017 REPORT, *supra* note 156; U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-663, FEDERAL STUDENT LOANS: EDUCATION COULD DO MORE TO HELP ENSURE BORROWERS ARE AWARE OF REPAYMENT AND FORGIVENESS OPTIONS (2015); Complaint, *Consumer Fin. Prot. Bureau v. Navient Corp.*, No. 3:17-cv-00101-RDM, 2017 WL 191446 (M.D. Pa. Jan. 18, 2017) (alleging that Navient steers borrowers into forbearance instead of options in the best interests of borrowers).

162. See *infra* Section II.A.

163. But see PRIVATE STUDENT LOANS, *supra* note 7, at 13 (suggesting 120 days is the norm for declaration of default on private student loans).



Center (NCLC) summarized the situation facing private student loan borrowers as follows:

Unlike the federal student loan programs, there is no comprehensive federal law requiring private student lenders to offer particular types of relief or flexible repayment. Private student loan borrowers are generally at the mercy of their creditors. Unfortunately, private lenders have been generally inflexible in trying to assist financially distressed borrowers.<sup>164</sup>

IDR—a critical component of the federal student loan program protections against borrower penury from education debt—is not a feature of the typical private student loan product for for-profit school students.<sup>165</sup> Similarly, no federal or state law provides private student loan borrowers a right to discharge debt on total disability, when a school closes, or for public service. Some lenders may voluntarily forbear or modify debts, but these actions typically are not contractual rights of the private student loan debtor but rather the calculation of a creditor as to whether loan modification offers a better chance for the recovery of money than obtaining a court judgment and pursuing collection.<sup>166</sup>

Private student loan borrowers have protections unavailable to federal student loan borrowers to the extent that some general laws of commerce and consumer lending apply to private student loans that are preempted by the Higher Education Act (HEA) or exclude federal student loans. For example, state usury limits can apply to private student loans but are preempted as to federal student loans.<sup>167</sup> Disclosure requirements under federal law are governed by the Truth in Lending Act (TILA), including special provisions for private student loans, while disclosures for federal student loans are stated in the HEA.<sup>168</sup>

Substantive protections for private student loan borrowers are almost nonexistent under state law. Three states have enacted limited laws focusing on conflict of interest in private student loan origination or requiring disclosures at origination. A 2013 Oklahoma law prohibits using school mascots or the like in

164. NAT'L CONSUMER L. CTR., *supra* note 140, § 12.7.1.

165. Some private student loans are in the form of income-share agreements. These loans have become newly popular as an emerging fintech product targeted at students in higher education programs leading to high-income occupations, but such loans are highly unlikely to be offered to for-profit school students. *See* Shu-Yi Oei & Diane M. Ring, *Human Equity? Regulating the New Income Share Agreements*, 68 VAND. L. REV. 681 (2015) (describing the new wave of income share agreements and arguing against comprehensive regulation).

166. A few of the larger private student loan lenders have publicly announced that they would consider a death or disability discharge on some loan programs, but these actions generally are limited to the discretion of the lender and are not widely available. NAT'L CONSUMER L. CTR., *supra* note 140, § 12.7.4.1.

167. 20 U.S.C. § 1078(d) (making state law “which limits the rate or amount of interest” inapplicable to federal loan that complies with rate requirements in HEA).

168. *Compare* 15 U.S.C. § 1638(e) (Truth in Lending Act disclosure provisions for private education loans), *and* 12 C.F.R. § 1026.46 (2020) (Regulation Z disclosure provisions for private education loans), *with* 15 U.S.C. § 1603(7) (dictating that loans under Title IV of the Higher Education Act do not apply to TILA). *See* NAT'L CONSUMER L. CTR., *supra* note 140, § 2.5.1 (federal loan disclosures); *id.* § 12.4.1.1 (private loan disclosures).

marketing private loans and prohibits school financial aid officers from personally profiting from private loans.<sup>169</sup> The State of Washington amended its higher education licensing law in 2018 to prohibit for-profit vocational school owners from profiting from private student loans, but the law narrowly applies to schools opening or renewing operations within the last two years and has exceptions allowing for such loans.<sup>170</sup> And California higher education licensing law requires certain disclosures about private and federal student loans.<sup>171</sup> The authors are unaware of any state law that attempts to provide any of the postorigination federal student loan repayment or discharge rights to private student loan borrowers that are available under federal law for borrowers with federal student loans.<sup>172</sup>

## 2. *Justifications for the Bankruptcy Discharge Exception*

Student loans generally are not dischargeable in bankruptcy. It was not always so. Prior to 1976, student loans were treated no differently than other types of debts in bankruptcy.<sup>173</sup> Federal student loans first were subject to a waiting period before becoming dischargeable—of five years from 1976 to 1990, then extended to seven years in 1990.<sup>174</sup> The 1998 amendments to the Bankruptcy Code eliminated the waiting period and instead made federal student loans of any duration dischargeable only if the debtor proves “undue hardship.”<sup>175</sup> Following the imposition of this restriction on bankruptcy discharge, the use of bankruptcy ceased to be a widely available tool for distressed federal student loan borrowers.<sup>176</sup> Even when a student

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169. OKLA. STAT. tit. 14A, § 3-704 (2013). The Oklahoma law also prohibits prepayment penalties, but that is a right that exists in federal law for all student loans, including under TILA for private student loans. 15 U.S.C. § 1650(e).

170. 2018 Wash. Sess. Laws 1235–36 (amending WASH. REV. CODE § 28C.10.050 (2018)).

171. CAL. EDUC. CODE § 69800 (West 2016) (stating that higher education institutions must “[c]learly distinguish private loans from federal loans in individual financial aid awards”); CAL. EDUC. CODE § 69800.2 (West 2017) (requiring disclosures about the availability of federal student loans).

172. The most substantial movement in state laws affecting private student loan borrowers is the growing number of states enacting licensing laws for student loan servicing of all types of student loans, including private student loans. See Walter Suskind, *Supporting States in the Fight to Protect Borrowers*, Blog for STUDENT BORROWER PROT. CTR. (Sept. 23, 2019), <https://protectborrowers.org/supporting-states-in-the-fight-to-protect-borrowers/> [https://perma.cc/6BZU-FPR2] (describing and listing states with servicing licensing laws).

173. Daniel A. Austin, *The Indentured Generation: Bankruptcy and Student Loan Debt*, 53 SANTA CLARA L. REV. 329, 363 (2013).

174. Between 1976 and 1990, the student debtor had to wait five years to discharge a loan in bankruptcy. That period was extended to seven years between 1990 and 1998. *Id.* at 363–64.

175. Higher Education Amendments of 1998, Pub. L. No. 105-244, 112 Stat. 1837 (eliminating seven-year limit on requiring proof of undue hardship).

176. PRIVATE STUDENT LOANS, *supra* note 7, at 71 (stating that student loans “are virtually immune from discharge in bankruptcy”). Whether undue hardship is an insurmountable mountain or a sometimes realistic, if inconsistently applied, alternative for some student loan debtors, is debatable. Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405, 437 (2005) (finding some relief granted in more than half of 286 undue hardship decisions); Aaron N. Taylor & Daniel J. Sheffner, *Oh, What a Relief It (Sometimes) Is: An Analysis of Chapter 7 Bankruptcy Petitions to Discharge Student Loans*, 27

loan borrower can obtain an undue hardship discharge, it requires a level of proof, expense, and outcome risk that would discourage borrowers from attempting to obtain the discharge.

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) included a provision adding “any other educational loan that is a qualified education loan” into the same provision requiring that federal student loans meet the undue hardship test to obtain a discharge in bankruptcy, thus bringing almost all private student loans within the undue hardship exception.<sup>177</sup> Prior to 2005, private student loan borrowers did not face these barriers to discharging student loans in bankruptcy.<sup>178</sup>

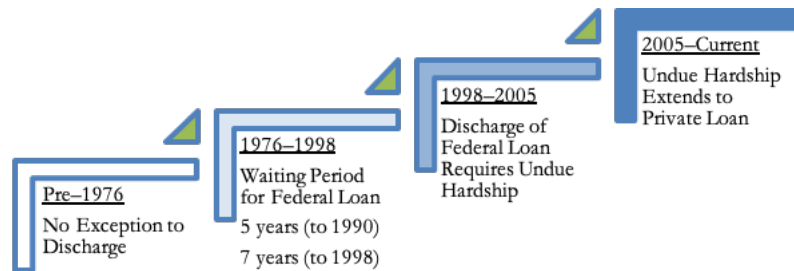


Figure 3: Bankruptcy Discharge Rights of Student Loan Debtors

Professor John Pottow has analyzed bankruptcy law in multiple nations and identified six possible rationales for restricting student borrower access to bankruptcy courts: fraud, soft fraud (opportunism), internalization, shaming, public

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STAN. L. & POL'Y REV. 295 (2016) (describing the undue hardship exception in bankruptcy for student loans and providing an empirical analysis rejecting the common perception that discharge is nearly impossible for student debtors). There is little doubt, however, that court decisions have discouraged its use. A January 15, 2020 opinion by Judge Cecelia Morris, the Chief Judge of the Bankruptcy Court for the Southern District of New York, describes how bankruptcy courts have employed a “certainty of hopelessness” approach to meeting the undue hardship standard and how this approach has led to “a quasi-standard of mythic proportions so much so that most people (bankruptcy professionals as well as lay individuals) believe it impossible to discharge student loans.” *Rosenberg v. N.Y. State Higher Educ. Servs. Corp.* (*In re Rosenberg*), 610 B.R. 454, 459 (Bankr. S.D.N.Y. 2020) (parenthetical in original). Judge Morris discharged Mr. Rosenberg’s debts and stated that “[t]his Court will not participate in perpetuating these myths” about the undue hardship standard. *Id.*

177. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCP) of 2005, Pub. L. No. 109-8, § 220, 119 Stat. 23, 59 (codified at 11 U.S.C. 523(a)(8)). “Qualified education loan” is defined by reference to section 221(d)(1) of the Internal Revenue Code of 1986. While not unlimited in scope as to private student loans, it broadly encompasses the vast majority of private student loans. See NAT’L CONSUMER L. CTR., *supra* note 140, §§ 11.2.3.4, 11.2.4.

178. Dalié Jiménez, A Tortuous History: The Student Loan Exception to Discharge (Apr. 10, 2014) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3544267](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544267) [https://perma.cc/8EWP-YSHF].

fisc, and cost of capital.<sup>179</sup> In imposing the initial waiting period restriction in 1978, “the articulated purpose of this legislation was to prevent a specific abuse, the filing of bankruptcy shortly after graduation for the primary purpose of discharging student loans.”<sup>180</sup> This rationale is consistent with Pottow’s soft fraud, or opportunism, justification for harsher treatment of student loans in bankruptcy—the concern that “students rack up huge educational debts only to waltz into bankruptcy the day after graduation.”<sup>181</sup>

Pottow argues that this rationale is not supportable because it makes no distinction between those using educational debts to become rich with the intent of never paying back the money and those who obtained no such benefit.<sup>182</sup> One could argue that the proper response to this situation was the original legislative solution of a waiting period, not an undue hardship test. Writing in 2007 before the broad expansion of IDR, Pottow describes the best response to the soft fraud concern as tying bankruptcy limits to IDR:

In contrast to the U.S. (and Canadian) mortgage-style regimes, which treat student debt as a lump-sum outlay that gets capitalized at graduation and then amortized over fixed-period installment payments, countries such as Australia and New Zealand (and recently, the United Kingdom) have embraced an income-contingent model. Repayment of student debt is a variable endeavor, and a repayment “tithe” is determined by a percentage of the debtor’s income.<sup>183</sup>

Thus, given the broad availability of IDR for federal student loans, one could argue that restrictions on bankruptcy discharge are justifiable when a student borrower can make payments scaled to income.<sup>184</sup> But this justification for imposing the undue burden obstacle has no application to private student loans. Private student loan borrowers have no access to IDR, with the exception of certain above-described income-share agreement loans.<sup>185</sup>

179. John Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, 44 CANADIAN BUS. L.J. 245 (2007).

180. Janice Kosol, *Running the Gauntlet of “Undue Hardship”—The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE L. REV. 457, 460 (1981). Richard Fossey noted that this conclusion was reached in the absence of any supporting information, as Congress had “virtually no evidence that the student borrowers who had filed for bankruptcy were acting in bad faith. No data existed on the circumstances of the debtors who had discharged their educational loans.” Richard Fossey, *The “Certainty of Hopelessness:” Are Courts Too Harsh Toward Bankrupt Student Loan Debtors?*, 26 J.L. & EDUC. 29, 34 (1997). In fact, a contemporaneous empirical study on the subject suggested little support for the argument that student borrowers abused bankruptcy. H.R. REP. NO. 95-595, at 161 (1977) (finding less than one percent discharge rate on student loans).

181. Pottow, *supra* note 179, at 266.

182. *Id.* at 266–67.

183. *Id.* at 267.

184. To be clear, we are not making the argument that the undue hardship exception is proper given IDR, but rather that IDR is a counterbalancing benefit that reasonably could be argued justifies imposing the undue burden restriction.

185. *Supra* Section I.C.1.b.

Furthermore, reliance on IDR is particularly important and appropriate because the federal government does not underwrite or restrict access to federal student loans. Student have a right to obtain federal student loans, and the federal government does not engage in ex ante underwriting of the student's likely ability to repay. A student with a C average in high school majoring in performance art with substantial credit card debt has as much right to a federal student loan as the high school A student in a nursing program with no other debt.

Not so with private lenders. Borrowers do not have a right to private student loans and also unlike federal government student lending, private lenders regularly conduct an ability-to-repay analysis prior to origination. As noted previously, private lenders overwhelmingly require cosigners for whom the ability-to-repay analysis is more meaningful. Accordingly, there is no more reason to absolve private student loan lenders of the consequence of their underwriting failure than there would be for any other type of creditor.

Nor is there any more reason to apply the cost of capital explanation to private student loans than other types of underwritten, unsecured debt. In any case, the argument for this rationale has been empirically disproven by Alexei Alexandrov and Dalié Jiménez, who establish that the 2005 BAPCPA change

did not result in low credit-score students at four-year undergraduate institutions paying less for PSLs, despite the fact that these loans were now presumptively nondischargeable. Second, we find no evidence that college students are sensitive to price, so that even if lenders had passed on the savings from BAPCPA in the form of lower prices, it likely would not have caused an increase in the number of students who took up loans.<sup>186</sup>

Some courts have suggested that the undue hardship test also is supported by the public fisc rationale—a desire to protect taxpayers. The Seventh Circuit articulated this position in *In re Roberson* as follows: “The government is not twisting the arms of potential students. . . . If the leveraged investment of an education does not generate the return the borrower anticipated, the student, not the taxpayers, must accept the consequences of the decision to borrow.”<sup>187</sup> The Eleventh Circuit cited *Roberson* in similarly adopting the public fisc justification.<sup>188</sup>

Again, this rationale has no application to private student loans, which do not use taxpayer money. With neither public money at issue nor a range of repayment and discharge options available, many of the reasons that could justify application

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186. Alexei Alexandrov & Dalié Jiménez, *Lessons from Bankruptcy Reform in the Private Student Loan Market*, 11 HARV. L. & POLY REV. 175, 208 (2017).

187. *In re Roberson*, 999 F.2d 1132, 1137 (7th Cir. 1993).

188. *In re Cox*, 338 F.3d 1238, 1242 (11th Cir. 2003) (quoting *Roberson* and adding that “Congress’s intent to make it harder for a student to shift his debt responsibility onto the taxpayer is clear from the 1998 amendments”).

of the undue hardship test have no purchase when considering private student loans.<sup>189</sup>

Discerning the possible rationales actually considered by Congress when it swept away generally available bankruptcy protection for private student loan borrowers is difficult because there is essentially no legislative history for this part of BAPCPA. The House Committee Report on BAPCPA referred to the expansion of the undue hardship to private student loans only by more or less repeating the text of the bill.<sup>190</sup> This absence of a legislative record is remarkable given the implications for the enormous private student loan market and the millions of private student loan borrowers. Even amongst the many dissenting opinions to the bill in general, no congressperson raised a concern over the changes to student loans.<sup>191</sup>

Whatever the motives for the BAPCPA amendments,<sup>192</sup> private student loan borrowers now face the same restrictions in bankruptcy as borrowers with federal student loans. Cosigners on student loans—a situation much more likely to occur with private student loans—likely also are subject to proof of undue hardship when seeking a discharge of the debt in bankruptcy.<sup>193</sup>

Parts II and III of this Article propose solutions that provide balance to this stripping of bankruptcy rights from private student loan borrowers. Part II looks at prospective state legislation that would incorporate some of the protections given to federal student loan borrowers into private loans used for-profit school attendance. Part III looks at state legislation that would limit the use of courts to collect private loans from former for-profit school students.

189. See also Rebekah Keller, Note, *The “Undue Hardship” Test: The Dangers of a Subjective Test in Determining the Dischargeability of Student Loan Debt in Bankruptcy*, 82 MO. L. REV. 211, 235 (2017) (arguing that “[f]ederal student loans should remain non-dischargeable in bankruptcy because of their status as public debts, because they fall within the category of government resources, and because the U.S. Department of Education has created many alternative ways for borrowers to repay their loans,” but that private loans should be dischargeable).

190. The only reference to the imposition of undue hardship exception for private student loans was as follows: “Sec. 220. *Nondischargeability of Certain Educational Benefits and Loans*. Section 220 of the Act amends section 523(a)(8) of the Bankruptcy Code to provide that a debt for a qualified education loan (as defined in section 221(e)(1) of the Internal Revenue Code) is nondischargeable, unless excepting such debt from discharge would impose an undue hardship on the debtor and the debtor’s dependents.” H.R. REP. NO. 109-31, pt. 1, at 62 (2005).

191. Rafael I. Pardo, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 181 (2009) (noting that the undue hardship exception “did not meet with any objections from lawmakers, even from the House members who expressed dissenting views to accompany the House Judiciary Committee’s report on the 2005 amendments”); Preston Mueller, *The Nondischargeability of Private Student Loans: A Looming Financial Crisis?*, 32 EMORY BANKR. DEVS. J. 230, 234–35 (2015).

192. Pardo suggests the motive for the change may be simple: “The history of the Bankruptcy Code’s student-loan discharge provision further bolsters the conclusion that Congress has been capitulating to the lender lobby.” Pardo, *supra* note 191, at 180.

193. Cf. Mueller, *supra* note 191, at 252.

## II. PROPOSAL ONE: PRIVATE STUDENT BORROWER PROTECTION ACT

In this Part, we describe model state legislation to prospectively create rights for private student loan borrowers attending for-profit schools. The proposed Private Student Borrower Protection Act (PSBPA) relies on the concepts underlying the FTC Holder Rule, which is described in Section II.A. The following two sections identify the loans subject to the requirements of the law, and the protections available under federal student loan law that are incorporated into the PSBPA. The final section examines the issue of federal preemption, concluding that this type of state legislation is not subject to HEA preemption but may be susceptible to National Bank Act preemption for certain lenders. In Appendix A, we offer suggested language for the model legislation.

### A. *The FTC Holder Rule*

The FTC Holder Rule provides a template for a consumer protection mechanism appropriate to the task here. Consumer protection law can roughly be divided into two types. First, consumer protection laws can be based on broad anti-fraud principles, most commonly in UDAP statutes. Second, consumer protection laws can incorporate rule-based protections, such as requiring market actors to take certain actions (e.g., make disclosures, give consumers an extended right to cancel, or comply with specified dispute procedures) or refrain from certain actions (e.g., charging interest in excess of certain limits, calling consumers on a do-not-call list, or threatening to sue debtors when the limitations period on the debt has expired).<sup>194</sup> The typical means for imposing these requirements is a statute or regulation that requires or prohibits conduct in identified transactions.

The FTC Holder Rule takes a unique approach to consumer protection that is appropriate to the situation that the PSBPA seeks to address. The primary mechanism for protection under the Holder Rule is the required incorporation of specific language into certain consumer finance contracts. Sellers of financed transactions, as defined under the rule, are required to insert a two-sentence provision into the consumer credit contract, which states the following in part: “Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller” (the Holder Rule provision).<sup>195</sup> The enforcement of the protections in the Holder Rule, therefore, essentially is self-executing through contract law. Under the Holder Rule, the derivative liability of the contract holder for the conduct of the seller is written into the credit contract. Indeed, the derivative liability of the contract holder exists by terms of the contract even when the Holder Rule provision was inserted by mistake; i.e., the contract

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194. In other words, the well-known standards versus rule distinction applies well in the field of consumer protection law. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

195. 16 C.F.R. § 433.2 (2020).

included the Holder Rule provision even though the Holder Rule did not apply to the transaction.<sup>196</sup>

Because the Holder Rule relies on contract law for enforcement, rather than typical statutory enforcement mechanisms, enforcement is problematic when the seller or original creditor with an obligation to insert the provision fails to comply. Failure to include the Holder Rule provision may give rise to a UDAP or other claim against the seller, but that defeats the purpose of creating derivative liability for the creditor who is more likely to be solvent and to have an incentive to resolve the claim when presented as a defense to collection.<sup>197</sup> State UDAP laws, state adoption of certain provisions of the Uniform Commercial Code, or other state law can provide an indirect mechanism for reading the Holder Rule into the credit contract as an implied term in these circumstances.<sup>198</sup>

The Holder Rule only applies when a consumer obtains financing for a purchase either directly from the seller<sup>199</sup> or when the seller refers the consumer for financing.<sup>200</sup> Referral includes financing through a creditor who has a business arrangement with the seller, which is broadly defined to include “[a]ny understanding, procedure, course of dealing, or arrangement, formal or informal” between the seller and creditor.<sup>201</sup>

An area in which the Holder Rule provides important protection is private student loans for for-profit school attendance. The Holder Rule does not apply to public entities or nonprofits acting as the seller.<sup>202</sup> A student attending a public university or nonprofit college who obtains a private student loan cannot expect to see the Holder Rule provision in their loan contract.<sup>203</sup> For students using private loans to attend a for-profit school, however, the Holder Rule clearly applies and provides a means for raising the type of defense to repayment that are available to federal student loan borrowers under the borrower defense rule.<sup>204</sup> This is one of the few consumer protections on which private student loan borrowers may rely.

The derivative liability imposed in the Holder Rule provides recourse to consumers that they otherwise would not be able to obtain. It also gives creditors an incentive to conduct due diligence on the sellers whose purchases it finances. This market-supervision function is more appropriately placed on a creditor seeking

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196. NAT’L CONSUMER L. CTR., FEDERAL DECEPTION LAW § 4.2.1 (3d ed. 2017).

197. *Id.* § 4.4.1.

198. *Id.*

199. The Holder Rule incorporates the Truth in Lending Act definition of a “credit sale” within the scope of covered transactions. 16 C.F.R. § 433.1(e) (2020).

200. The Holder Rule incorporates the Truth in Lending Act definition of a “[p]urchase money loan” as part of defining the scope of covered transactions. *Id.* § 433.1(d).

201. *Id.* § 433.1(g).

202. But when a public entity or nonprofit is the creditor in a transaction in which the seller is covered under the Holder Rule, the credit contract may need to include the Holder Rule provision. *See* NAT’L CONSUMER L. CTR., *supra* note 196, § 4.2.2.6.

203. *Id.*

204. *Id.*; NAT’L CONSUMER L. CTR., *supra* note 140, § 10.6.



to benefit from a regular flow of loan origination from a for-profit school than it is on a single student of such a school. As the FTC stated in promulgating the rule,

Consumers are not in a position to police the market, exert leverage over sellers, or vindicate their legal rights in cases of clear abuse. The sheer expense of obtaining an accurate assessment of the likelihood of seller misconduct in a particular case are prohibitive. . . . [Under the Holder Rule], [c]reditors will simply not accept the risks generated by the truly unscrupulous merchant. The market will be policed in this fashion and all parties will benefit accordingly.<sup>205</sup>

As described below, the Holder Rule's unique consumer protection mechanism and its market regulating function are well suited to accomplish the purpose of the PSBPA.

### *B. Loans and Borrowers Within Scope of the Act*

This Section describes the scope of the PSBPA—which loans and which borrowers to which it applies.<sup>206</sup> It also fleshes out the analogy to the Holder Rule by comparing the scope of the regulatory schemes.

#### *1. Student Loans by a Nonpublic Lender for Attendance at For-Profit Schools*

The PSBPA applies to private student loans for attendance at a for-profit school. Each of these scope provisions is discussed below.

The guiding concept of the Act is to provide the rights of federal student loan borrowers to *private student loan borrowers* in order to counterbalance the undue hardship obstacle to bankruptcy protection. The Act, therefore, incorporates the definition of “qualified education loans” used in the Bankruptcy Code to include private student loans within the undue hardship exception, which is a term incorporated by reference from the Internal Revenue Code.<sup>207</sup> The Act then expressly excludes government student loans—again using the Bankruptcy Code definition—because “qualified education loans” could otherwise encompass such loans.<sup>208</sup> In addition to excluding federal student loans, this provision also would mean that loans by state government entities would not be covered by PSBPA

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205. Statement of Basis and Purpose of Trade Regulation Rule Concerning the Preservation of Consumer Claims and Defenses, 40 Fed. Reg. 53523 (Nov. 18, 1975).

206. The PSBPA scope provisions incorporate by reference terms of federal law in numerous instances. Each state considering adoption of the PSBPA should evaluate the particular meaning of such an incorporation by reference under that state's law. *See generally* F. Scott Boyd, *Looking Glass Law: Legislation by Reference in the States*, 68 LA. L. REV. 1201 (2008) (tracing the development of the statutory-incorporation-by-reference doctrine, the types of statutory references, courts' expansionist interpretation of the doctrine, and the interaction between the doctrine and the non-delegation doctrine).

207. 26 U.S.C. § 221(d) (incorporated by reference in 11 U.S.C. § 523(a)(8)(B)).

208. 11 U.S.C. § 523(a)(8)(B).

protections.<sup>209</sup> If an arguably private student loan is not defined as such under these terms, it should also not be subject to the bankruptcy undue hardship exception, and thus there is not the need for a ballast of compensating borrower protections.<sup>210</sup>

The PSBPA does not exclude from its scope all nonprofit lenders: a group of lenders covered by the undue hardship exception language.<sup>211</sup> Including nonprofit lenders is consistent with providing protections to student borrowers who lack ready access to bankruptcy discharge and lack access to federal student loan protections.<sup>212</sup> An exception to this inclusion of nonprofit lenders is that the PSBPA excludes from its scope nonprofit lenders with government affiliation, for the same reasons that loans by state entities are excluded.<sup>213</sup>

The Act incorporates the HEA definition of *for-profit schools*, deemed “proprietary institutions of higher education” in the HEA.<sup>214</sup> This definition expressly excludes public and nonprofit institutions.<sup>215</sup> The Act focuses on private loans to for-profit school students because the nexus of private loans and for-profit schools has been an area of repeated abuse. The problems with for-profit schools, including the targeting of veterans and minorities, has ebbed and flowed for decades, at least since World War II.<sup>216</sup> Protecting for-profit students from abusive private loans is a long-term problem that has needed, and likely will continue to need, a long-term public policy solution.

209. Some state governments operate loan programs. *See, e.g., About SELF Loans*, MINN. OFF. HIGHER EDUC., <http://www.selfloan.state.mn.us/index.cfm> [<https://perma.cc/VC2A-TLVS>] (last visited Sept. 27, 2020) (describing the SELF loan programs as “a long-term, low-interest student loan . . . administered by the Minnesota Office of Higher Education, a state agency” and stating that “the interest rates may be lower than private loans and some federal loans”); Andrew Wold, *Alt-Remedies to Paying Student Loans: In Some Cases, Relief Is Available*, 76 BENCH & BAR MINN. 27, 29 (2019) (describing SELF program).

210. For a discussion of the narrow universe of loans that may not be covered by the undue hardship exception, see NAT’L CONSUMER L. CTR., *supra* note 140, §§ 11.2.3.1, .3.

211. 11 U.S.C. § 523(a)(8)(A)(i).

212. Including nonprofit lenders also would help prevent the covert use of a nonprofit by a for-profit institution. *See infra* notes 215–17 and accompanying text. One could imagine a for-profit institution establishing a nonprofit lender to make loans to attend a for-profit school and thus claiming these loans were excluded from coverage by the PSBPA. The Act also does not exclude the reference to “an obligation to repay funds received as an educational benefit, scholarship, or stipend” in 11 U.S.C. § 523(a)(8)(A)(ii). This odd category of repayment obligations would fall within the scope of the PSBPA, but only if the other scope provisions apply.

213. The 2019 GAO Report described this group of lenders as follows: “Nonbank state lenders provide private student loans to residents of their states and out-of-state students attending in-state schools. These lenders are mission-driven entities focused on increasing college access and affordability in their states, among other things, and are funded through tax-advantaged bond funding.” GAO-19-430, *supra* note 16, at 3 n.7.

214. 20 U.S.C. § 1002(b). For a history of the derivation of this term under the HEA, see Ass’n of Proprietary Colls. v. Duncan, 107 F. Supp. 3d 332, 341–42 (S.D.N.Y. 2015).

215. A “proprietary” institution is one that “does not meet the requirement of paragraph (4) of section 1001(a) of this title,” 20 U.S.C. § 1002(b)(1)(C), which “is a public or other nonprofit institution,” 20 U.S.C. § 1001(a)(4).

216. *Supra* Section I.B.

Nonprofit schools are excluded along with public institutions in the proposed scope provisions of the PSBPA. A concern with this exclusion is that there is a growing problem of for-profits covertly using nonprofits to circumvent consumer protections. For-profit school owners establish a nonprofit that they control, effectively negating the nonprofit purpose. Lack of effective Internal Revenue Service (IRS) control makes the problem difficult to remedy.<sup>217</sup> As Robert Shireman has noted, “of all schools claiming nonprofit status for at least five years, the three with the most fraud complaints [by student borrowers] are covert for-profits—conversions in which power never actual shifted away from owners who have an ongoing financial interest.”<sup>218</sup>

Accordingly, the PSBPA includes a provision including within the scope of the Act a nonprofit substantially operated or controlled by a for-profit institution. Ultimately, the problem of covert nonprofits is an enforcement issue for the IRS and state authorities. A law enacted in Maryland in 2019 and legislation pending in California provide models for increased enforcement to address this problem.<sup>219</sup>

## 2. *In-State Students of Online Schools Covered*

States clearly have an interest in protecting students when loans are originated for physical attendance at a school located in the state. Yet a focus on for-profit schools also necessitates attention to the online learning space. The PSBPA covers students attending schools with a physical presence in the state and students who reside in the state while obtaining a private loan to attend an online school without a physical presence in the state.

The number of students completing online-only education has increased over time, unsurprisingly. The percentage of total undergraduate enrollment with classes solely through online learning rose from 3.8% in 2007–2008 to 6.5% in 2011–2012 to 10.8% in 2015–2016.<sup>220</sup> For-profit schools are disproportionately enrolling these students, especially out-of-state online students. As shown in Table 1, for-profit schools enrolled only about 5.5% (1.09 million) of the total higher education

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217. Robert Shireman, *These Colleges Say They're Nonprofit—But Are They?*, CENTURY FOUND. (Aug. 24, 2018), <https://tcf.org/content/commentary/colleges-say-theyre-nonprofit> [<https://perma.cc/5Z28-8J8U>]; Brian Galle, *Conversions of For-Profit to Nonprofit Colleges Deserve Regulators' Scrutiny*, MEDIUM (Apr. 3, 2018), <https://medium.com/whatever-source-derived/conversions-of-for-profit-to-nonprofit-colleges-deserve-regulators-scrutiny-1b9174cf534d> [<https://perma.cc/TND7-PCUC>]; see also Marguerite Mills, *Privatization of Public Education: Balancing Students and the Bottom Line*, 6 EMORY CORP. GOVERNANCE & ACCOUNTABILITY REV. 1091 (2019), <https://law.emory.edu/ecgar/perspectives/volume-6/perspectives/privatization-public-education-students-bottom-line.html> [<https://perma.cc/M8SP-SGHR>] (describing the case of Purdue Global).

218. Shireman, *supra* note 217.

219. MD. CODE ANN., EDUC. § 10-101 (West 2019); Assemb. B. 1341, 2019–2020 Leg., Reg. Sess. (Cal. 2019), [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB1341](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB1341) [<https://perma.cc/D6NW-S5FD>].

220. *Digest of Education Statistics: Table 311.22*, NAT'L CTR. FOR EDUC. STAT., [https://nces.ed.gov/programs/digest/d18/tables/dt18\\_311.22.asp](https://nces.ed.gov/programs/digest/d18/tables/dt18_311.22.asp) [<https://perma.cc/N2JU-3RYV>] (last visited Sept. 27, 2020).

enrollment of 19.76 million students in 2017, but they enrolled about 21% (.657 million) of the 3.1 million online-only students.<sup>221</sup> Approximately sixty percent of for-profit school students are online-only, or more than three times the percentage of online-only students compared to private nonprofit institutions and more than five times the percentage of online-only students compared to public institutions.<sup>222</sup> These for-profit online students draw from a broad geographic area. While approximately eighty-four percent of online-only students at public institutions were in-student residents, only approximately sixteen percent of for-profit online-only students were in-student residents.<sup>223</sup>

	<b>Total Enrollment</b>	<b>Online-Only Classes</b>	<b>% Total Enrollment Online-Only</b>
<b>Public</b>	14,560,155	1,657,185	11.4%
<b>Private Nonprofit</b>	4,106,477	788,407	19.2%
<b>Private For-Profit</b>	1,098,966	657,908	59.9%

Table 1: Online-Only Enrollment by Type of Institution, 2017<sup>224</sup>

Schools that are predominantly online-only—meaning more than ninety percent of their students are exclusively online—are dominated by for-profit institutions.<sup>225</sup> Of the 103 higher education institutions that fit this definition, approximately sixty-five percent are for-profit.<sup>226</sup>

Regulation of online higher education is a bit of a mess. A key difficulty in this area has been determining how authorization of a higher education institution should occur when the program offered is online. States are an integral part of the authorization system, but the ED also has a critical role, including determining which online students are eligible for federal student loans based on the various state authorizations.<sup>227</sup> The vast majority of states, with the notable exception of

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221. *Digest of Educational Statistics: Table 311.15*, NAT'L CTR. FOR EDUC. STAT., [https://nces.ed.gov/programs/digest/d18/tables/dt18\\_311.15.asp](https://nces.ed.gov/programs/digest/d18/tables/dt18_311.15.asp) [https://perma.cc/8JBW-ZTU4] (last visited Sept. 27, 2020) (Fall 2017 enrollment).

222. *Id.*

223. *Id.*

224. *Id.*

225. *Digest of Educational Statistics: Table 311.33*, NAT'L CTR. FOR EDUC. STAT. n.1, [https://nces.ed.gov/programs/digest/d18/tables/dt18\\_311.33.asp](https://nces.ed.gov/programs/digest/d18/tables/dt18_311.33.asp) [https://perma.cc/Y75N-TVAJ] (last visited Sept. 27, 2020) (Fall 2017 enrollment).

226. *Id.* at tbl.311.33.

227. Lindsay McKenzie, *Rethinking State Authorization, Again*, INSIDE HIGHER ED (Jan. 23, 2019), <https://www.insidehighered.com/digital-learning/article/2019/01/23/education-department-revisits-state-authorization-online> [https://perma.cc/ERX4-39P7] (“After almost 10 years of discussion, one thing is clear: state authorization is complex. Few groups agree on exactly how it should be done, or even if it should be done at all. Yet Education Department officials are optimistic they can find a way forward that will make the rules simpler for colleges. The test will be whether they can do so without significantly reducing consumer protections for students.”). The HEA includes the notion of online learning in the term “distance education,” 20 U.S.C. § 1003(7), but the relevant provisions of the HEA do not substantially address how to resolve state authorization concerns.

California, have entered into some form of the State Authorization Reciprocity Agreement (SARA), an interstate compact designed to bring continuity to state authorization of online schools.<sup>228</sup> The Act incorporates the terminology of SARA for “physical presence” and “distance education” to effectuate the goal of covering students who either attend an in-state school or have a primary residence in the state while attending an online school that does not have a physical presence in the state.<sup>229</sup>

### 3. *The Usefulness of the Holder Rule Analogy*

The concept underlying the Holder Rule—that consumer protections are written into consumer contracts—provides a useful tool for the purpose of the PSBPA. Most consumer finance protections work by regulating contract formation or terms of credit that are apparent at the time of origination,<sup>230</sup> such as disclosures or representations made prior to the execution of the contract,<sup>231</sup> substantive terms that are fixed at the time of origination,<sup>232</sup> or rights to cancel that arise within days of the loan origination.<sup>233</sup> The rights of the borrower in these situations can be determined at or near the time of origination. Accordingly, when borrowers move to other states after loan origination, the time for effect of the state law protections has already occurred and an issue of whether the law in the originating state applies to the loan does not arise, absent preemption by federal law.<sup>234</sup>

The protections in the PSBPA, however, often depend on conditions that arise subsequent to the origination of the student loan, such as disability discharge or the amount of repayment under IDR, that may occur at a time when the student borrower lives in another state. Following the logic of the Holder Rule, these protections would be in the contract terms and thus follow the borrowers to any other state. This is a particularly useful feature given that students often are mobile both while they are attending higher education institutions and after they graduate.<sup>235</sup> Absent use of the Holder Rule concept, questions might also arise as to

228. *NC-SARA Institution Directory*, NC-SARA, <https://www.nc-sara.org/directory> [<https://perma.cc/U9Q9-Y48A>] (last visited Sept. 27, 2020).

229. NAT’L COUNCIL FOR STATE AUTHORIZATION RECIPROcity AGREEMENTS, *SARA MANUAL* 40–42 (version 20.1 2020).

230. *See, e.g.*, U.C.C. § 2-302 (AM. L. INST. & UNIF. L. COMM’N 2020) (stating that courts may refuse to enforce unconscionable contracts).

231. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 164 (AM. L. INST. 1981) (discussing what misrepresentations make a contract voidable); *supra* text accompanying notes 168, 169, 171.

232. *See, e.g.*, CAL. CONST. art. XV, § 1 (setting usury limits for certain loans).

233. *See, e.g.*, 15 U.S.C. § 1635(a) (setting out a three-day cancellation period for home equity loans or lines of credit).

234. *See, e.g.*, Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 521 (2004) (describing the use of the “exportation doctrine” to preempt state regulation of consumer finance contracts initiated by a national bank).

235. DOUG SHAPIRO, AFET DUNDAR, FAYE HUIE, PHOEBE KHASIALA WAKHUNGU, AYESHA BHIMDIWALA, ANGEL NATHAN & YOUNGSIK HWANG, NAT’L STUDENT CLEARINGHOUSE RSCH. CTR., SIGNATURE REP. 15: TRANSFER AND MOBILITY: A NATIONAL VIEW OF STUDENT

whether a borrower with private student loans from a for-profit school who moves after graduation from a state with no PSBPA to a state with PSBPA protections would be afforded those protections. Under the PSBPA use of the Holder Rule, lenders would not have been obligated to insert protections into the loan contracts and such borrowers would not be covered under the protections of the Act.

The market-regulating function of the Holder Rule also is helpful in the context of borrowing by for-profit school students. When lenders have to accept certain risks attributable to the conduct and usefulness of the for-profit school's educational program, underwriting will mean evaluating each for-profit school to determine the likelihood that it will close or other school-related discharge rights, and the likelihood that the school's graduate will earn enough to pay back the loan under an IDR formula.

One limitation of the Holder Rule is that it lacks an explicit enforcement mechanism when sellers and lenders within the scope of the rule fail to include the required provision in the consumer contract.<sup>236</sup> This is a particular problem for the Holder Rule because the FTC Act lacks a private right of action. The PSBPA resolves this problem by including a provision that any contract within the scope of the Act that fails to include the required contract terms shall be deemed to have incorporated those terms in the contract and the lender shall be deemed to have violated the state UDAP law, thus providing for a fee-shifting private right of action in almost every state.<sup>237</sup>

### *C. Federal Student Loan Protections Incorporated in the PSBPA*

We earlier identified four categories of protections afforded to federal student loan borrowers—repayment rights, disability discharge, school-related discharge, and public service discharge.<sup>238</sup> The purpose of the PSBPA is to balance the existence of obstacles to bankruptcy with state law protections analogous to the protections afforded to federal student loan borrowers. In this Section, we identify which of the federal student loan protections achieve this objective while not unduly impeding the access to private student loans for for-profit students. We also note which of the protections can be managed with due diligence on the part of the lender and thus are consistent with the market-regulating function of the Holder

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MOVEMENT IN POSTSECONDARY INSTITUTIONS, FALL 2011 COHORT 20–21 (2018) (“Nearly half of students who started at four-year private nonprofit institutions and for-profit institutions transferred out-of-state . . . .”); NAT’L STUDENT CLEARINGHOUSE RSCH. CTR., SNAPSHOT REPORT: INTERSTATE MOBILITY (2012), <https://nscresearchcenter.org/wp-content/uploads/SnapshotReport5-InterstateMobility.pdf> [<https://perma.cc/2G9C-QXQC>] (“On average, 15.1 percent of all U.S. postsecondary students who received undergraduate degrees in 2010–11 had previously attended college in at least one other state or territory.”).

236. See *supra* text accompanying notes 197–198.

237. Debra Pogrud Stark & Jessica M. Choplin, *Does Fraud Pay? An Empirical Analysis of Attorney’s Fees Provisions in Consumer Fraud Statutes*, 56 CLEV. ST. L. REV. 483, 518–24 app. (2008) (providing a list of state fee-shifting provisions with private UDAP enforcement).

238. *Supra* Section I.C.1.a.

Rule. The PSBPA adopts a form of IDR tied to federal IDR payments and incorporates federal disability and school-related discharge protections but does not require private loans to offer public service discharge.

### 1. *IDR Rights*

The most important of the safeguards afforded to federal student loan borrowers are *repayment rights*, and the most important repayment right across the totality of borrower circumstances is IDR. As noted by Professor Pottow, IDR that allows calibration of repayment to income is the only reasonable justification of a bankruptcy discharge exception for student loans.<sup>239</sup> The PSBPA incorporates IDR by linking private loan repayment to federal student loan repayment when all of a borrower's federal student loan repayments are made through IDR, as follows:

\* Private loan monthly repayment amounts are limited to thirty percent of the federal loan IDR payment made by the borrower who attended the higher education institution, without regard to income of coborrowers. The thirty percent amount is calculated without regard to prepayment of the federal loans to obviate the risk to the lender of the student borrower prepaying only the federal student loan for purposes of effectively discharging the private student loan.

\* The private lender with the oldest originated loan obtains the full benefit of the limited IDR payment, with any remaining eligible payment allocated to private lenders in order of loan origination.

\* Once the borrower has made all required federal IDR payments for the full number of years, typically twenty years, no future payments would be due on the private loan and the loan would be considered fully repaid.

\* If the borrower did not obtain any federal student loans for attendance at the school receiving the benefits of the loan proceeds, then the lender would be required to offer any borrower in default the option of a loan modification limiting future payments to the same terms as the PAYE IDR program.

\* If the student borrower elects not to repay federal loans through IDR, then the private loan payments would not be eligible for IDR, which is consistent with the purpose of the PSBPA to incorporate federal student loan protections.

This approach allows a simple benchmark method of determining IDR payments. Creating parallel outcomes for the federal and private student loans makes sense because the rationale for incorporating these rights in state law is to provide private student loan borrowers some of the protections available to federal student loan borrowers. Parallel determination of loan payment amounts also should be relatively efficient for lenders, as there are a limited number of loan servicers for student loans, and thus the loan servicer is likely to understand the requirement of federal student loan repayment and discharge rights.<sup>240</sup>

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239. Pottow, *supra* note 179, at 266–67.

240. NAT'L CONSUMER L. CTR., *supra* note 140, § 5.2.1.1.

The PSBPA allocates access to these thirty percent payments by date of origination of the private loan. Unlike federal loans, which are all made directly by the federal government after 2011, there can be multiple private student loan creditors. This can be true even when the loans were originated by the same entity because the loans can be sold in the secondary market. When more than one private student loan is securitized, it is almost certain that the borrower's loans will be owned by multiple entities, typically a trust.<sup>241</sup>

The PSBPA, therefore, states that the percentage limit tied to federal IDR payments is the total for all private student loans owed by that borrower and access to this thirty percent repayment amount is allocated by date of origination. This gives private lenders an incentive to maintain a higher relative balance of federal to private student loans and cease lending when the private share of IDR payments will go to prior in time loans and lenders. It also provides an incentive to for-profit schools to direct students to federal loan programs when possible. This directly targets one of the abuses of for-profit school students, which is the use of high-cost student loans when federal student loans are available.<sup>242</sup>

## 2. Discharge Rights

School-related discharges offer the clearest case for inclusion in the PSBPA. Allowing such discharge promotes exactly the sort of lender due diligence supporting the reason for the Holder Rule because the lender is in the best position to more efficiently determine whether a school engages in practices that would expose it to such risks. It also is consistent with fairly balancing the lack of bankruptcy discharge rights if the expected benefits of the loan are not realized because of school misconduct. For example, the right to discharge a federal student loan when a school falsely certifies that its program meets relevant state requirements for employment in the field of training is an archetype of the kind of problems encountered by for-profit school students.<sup>243</sup> Private student loan discharge should follow from federal student loan discharge.

The disability discharge protections available to federal student borrowers also meet the purposes of the PSBPA. A person with a total and permanent disability and resulting lack of income would typically be eligible for a simple bankruptcy discharge of a private student loan absent the undue hardship provision. Requiring this protection through state law directly compensates for the loss of bankruptcy rights.

The public service discharge, however, is not a right incorporated into the PSBPA. These programs use loan forgiveness by the federal government to incentivize and reward public service. This laudable goal reduces the burden of loan

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241. See Levitin & Twomey, *supra* note 133, at 13–15 (describing analogous mortgage servicing process resulting in ownership of a loan by a trust or other single-purpose vehicle).

242. *Supra* note 40 and accompanying text.

243. See, e.g., Vasquez, *supra* note 100.



repayment primarily for a reason unrelated to making federal student loan repayment proportionate to ability to repay. Nor is this type of discharge consistent with the Holder Rule function of shifting due diligence to the lender.

Similar to IDR rights, the PSBPA uses the exercise of the federal right to loan discharge as a proxy for the availability of the right as to the private student loan if the PSBPA incorporates that right. If the federal student loan has been discharged, the private student loan is similarly discharged if that federal discharge right is incorporated in the contract through the PSBPA.<sup>244</sup> If the federal student loan is in forbearance or deferment pending a decision on the availability of the discharge, then the same status applies to the private student loan if the borrower's application was made in good faith. Similarly, if the federal right requires a substantive determination, the PSBPA states that a determination by the ED shall control as to any right conferred under the contract provisions required to be included by the PSBPA.

#### *D. Preemption*

States can legislate the terms and conditions of private student loans without concern for preemption under the HEA.<sup>245</sup> Loans made by a national bank, however, raise preemption concerns under the National Bank Act (NBA).

The Dodd-Frank Act changed the terms of NBA preemption by explicitly adopting the *Barnett Bank* decision to determine when a "[s]tate consumer financial law prevents or significantly interferes with" the activities of a national bank.<sup>246</sup> An examination of NBA preemption is beyond the scope of this Article, but it seems possible that national bank lenders would not have to comply with the terms of the PSBPA. A state considering adopting the PSBPA should consider adding a provision exempting compliance for loans originated by a national bank.

Even if national banks are free to ignore the requirements of the PSBPA under NBA preemption, the PSBPA would provide a powerful tool to provide some protections to this forgotten segment of for-profit school students with private loans. First, while private student loans mostly are made by national banks, that is not the case with private loans to for-profit school students. The financial crisis curtailed private student lending, but bank funding of for-profit schools was particularly impacted. As the CFPB reported in its 2012 study of private school loans, "[w]hen bank-funded private student loans became unavailable to students at

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244. If there is a partial discharge on federal loan for a borrower defense, then a proportionate percentage should be given for the private loan.

245. State law authority over private student loans applies even when the same laws might be preempted in some cases as to federal student loans. *See* NAT'L CONSUMER L. CTR., *supra* note 140, § 14.2.4.2 (observing that HEA "preemption of state debt collection claims is not an issue for private student loans, but it may be for federal student loans."); *id.* § 14.3.4 ("Suits against servicers of private student loans cannot claim HEA preemption, even if the same servicer services federal student loans."); *id.* § 14.5.2.4.5 ("Private student loans are not regulated by the HEA so there is no HEA preemption of state law claims against private student loan lenders.")

246. 12 U.S.C. § 25b(b)(1)(B).

for-profit schools, some proprietary programs began lending directly to their students in response.”<sup>247</sup> NBA preemption would not be relevant to proprietary school self-funding or other non-bank funding methods.

Second, there are limits to the reach of national bank lending here. Not all loans that are nominally made by a national bank fall under NBA preemption. In particular, “rent-a-bank” arrangements have been found to invalidate application of NBA preemption.<sup>248</sup> This type of scheme has occurred with private student loans. Navient, for example, was alleged to have used Stillwater National Bank as a front for their loans, and thus NBA preemption might not have applied to such loans.<sup>249</sup>

Third, even if the impact of the PSBPA is to shift more private for-profit school lending to national banks, such a move would at least bring a percentage of private lending from the shadow banking sector into the bank supervision system. To the extent that certain for-profit school practices can be exposed as unfair or deceptive, and thus introducing risk, federal banking regulators could be pressured to place general limits on the associated lending practices, as occurred following the financial crisis.<sup>250</sup>

### III. PROPOSAL TWO: PRIVATE STUDENT LOAN MEDIATION ACT

Our second proposal, the Private Student Loan Mediation Act (PSLMA) would provide resources to the growing number of private student loan borrowers currently in default. This model state legislation would require mediation on defaulted private student loans before initiating legal proceedings. This concept is modeled after the mandatory mediation programs that were implemented in response to the foreclosure crisis. The following sections look at the recommended features of a private student loan mediation program. In Appendix B, we provide suggested language for the model legislation.

#### *A. Usefulness of the Foreclosure Mediation Analogy*

There are many parallels to mortgage servicing problems experienced by homeowners leading up to and during the financial crisis and the looming student loan debt crisis. During the financial crisis, millions of American families faced

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247. PRIVATE STUDENT LOANS, *supra* note 7, at 33.

248. See Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 105–06 (2002) (describing the rent-a-bank scheme with payday lending); Consumer Fin. Prot. Bureau v. CashCall, Inc., No. CV157522JFW(RAOx), 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) (rejecting NBA preemption in rent-a-bank circumstance).

249. *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, 1203 (N.D. Cal. 2012).

250. See, e.g., 12 C.F.R. § 3.2 (2020) (setting out the definitions of the risk-based capital frameworks from Basel III). Perhaps for-profit schools that have been exposed for unfair and deceptive practices could incur a higher risk-weight in the risk-based capital framework, which might force banks to hold less of these loans and could encourage banks to monitor for-profit schools. See generally RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, *THE LAW OF FINANCIAL INSTITUTIONS* 215–32 (Vicki Been et al. eds., 5th ed. 2013) (describing the application of the risk-based capital framework from Basel III).

foreclosure. In a comment to the CFPB, the Connecticut Department of Banking noted the parallels between problems with student loans and government response during the mortgage crisis—“this is not déjà vu. We have been here before.”<sup>251</sup> As such, “senior government officials, federal regulators, state law enforcement agencies, consumer advocates, and others have suggested that the steps taken by policymakers to strengthen servicing protections for homeowners may offer an instructive analogy for policymakers and market participants with regard to the student loan servicing market.”<sup>252</sup>

One of the most effective of measures to address the mortgage crisis was the use of mandatory preforeclosure mediation. An analysis of the state and local negotiated foreclosure alternatives adopted between 2008 and 2014 “uniformly supports the effectiveness of foreclosure mediation in achieving loan modifications and other resolutions that avoid the need for foreclosure sales.”<sup>253</sup> Mediation could be effective with private student loan default because it addresses the failures of servicers to effectively inform borrowers of repayment options and because it changes the dynamics of debt negotiation.

Private student loan borrowers often cannot access existing repayment options that private lenders may be willing to offer the borrower. As extensively described above, private student loans do not offer the same repayment plan and discharge options as federal student loan borrowers. Nonetheless, “a number of large private student lenders have developed alternative repayment options that take into account borrowers’ financial circumstances.”<sup>254</sup> In fact, the five banks with the

251. *Request for Information on Student Loan Servicing*, REGULATIONS.GOV, <https://www.regulations.gov/docketBrowser?rpp=50&so=DESC&sb=postedDate&po=0&s=CFPB-2015-0021-0381&dct=PS&D=CFPB-2015-0021> [<https://perma.cc/8UG4-JCB2>] (last visited Sept. 27, 2020).

252. CONSUMER FIN. PROT. BUREAU, STUDENT LOAN SERVICING: ANALYSIS OF PUBLIC INPUT AND RECOMMENDATIONS FOR REFORM 13 (2015) [hereinafter STUDENT LOAN SERVICING], [https://files.consumerfinance.gov/f/201509\\_cfpb\\_student-loan-servicing-report.pdf](https://files.consumerfinance.gov/f/201509_cfpb_student-loan-servicing-report.pdf) [<https://perma.cc/V9VU-C4SA>] (citing Press Release, Ted Mitchell, Under Sec’y, U.S. Dep’t of Educ., Remarks at the Federal Student Aid (FSA) Servicing Summit in Atlanta, GA (Dec. 1, 2014), <http://www.ed.gov/news/speeches/prepared-remarks-us-under-secretary-education-ted-mitchell-federal-student-aid-fsa-servicing-summit-atlanta-ga> [<https://perma.cc/Q33J-L8KD>]); Press Release, Sarah Bloom Raskin, Deputy Sec’y, U.S. Dep’t of the Treasury, Remarks on Student Loans at the National Consumer Law Center’s Annual Consumer Rights Litigation Conference (Nov. 6, 2014), <https://www.treasury.gov/press-center/press-releases/Pages/JL2689.aspx> [<https://perma.cc/ZY9V-EC7N>]; *The U.S. Economic and Fiscal Outlook: Hearing Before the Joint Econ. Comm.*, 113th Cong. (2014) (testimony of Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System), <https://www.jec.senate.gov/public/index.cfm/hearings-calendar?ID=4394DB09-A2E8-4098-95EF-39F0B7E8C75B> [<https://perma.cc/RN9K-TXM3>]; Letter from Lisa Madigan, Att’y Gen., Ill. Off. of the Att’y Gen., to Arne Duncan, Sec’y, U.S. Dep’t of Educ. (June 1, 2015), [http://www.illinoisattorneygeneral.gov/pressroom/2015\\_06/ArneDuncanLetter.pdf](http://www.illinoisattorneygeneral.gov/pressroom/2015_06/ArneDuncanLetter.pdf) [<https://perma.cc/Q7DJ-NK4P>].

253. Alan M. White, Foreclosure Mediation: An Experiment that Worked 7 (Jan. 29, 2016) (unpublished manuscript), <https://ssrn.com/abstract=2724732> [<https://perma.cc/ZC48-C6GT>].

254. STUDENT LOAN SERVICING, *supra* note 252, at 21; *see also*, Letter from Navient, to Monica Jackson, Off. of the Exec. Sec’y, Consumer Fin. Prot. Bureau (July 13, 2015), <https://www.regulations.gov/document?D=CFPB-2015-0021-0355> [<https://perma.cc/JG6E->

largest private student loan portfolios offer alternative payment programs.<sup>255</sup> Yet many borrowers have no idea these options are available to them because the process for applying for these options are unclear and the eligibility criteria is not publicly available.<sup>256</sup> And the National Consumer Law Center concludes that “[p]rivate loan lenders and loan holders rarely offer reasonable settlements.”<sup>257</sup> Which is, in part, because none of the five banks with the largest private student loan portfolios offer alternative payment programs after default believing them to be unnecessary because of the availability of alternative payment before default.<sup>258</sup>

As with the mortgage crisis, loan servicers are an obstacle to mutually beneficial loan modifications. Borrowers are often unable to obtain even basic information about alternative repayment plans.<sup>259</sup> Often this information is not advertised on servicers’ websites or “included in [the] borrowers’ promissory notes or loan contracts.”<sup>260</sup> Borrowers express frustration about the process for obtaining a decision, including customer service representatives being “unable to identify appropriate personnel who can make a determination about repayment options” and refusing to provide information about why a repayment plan option was denied.<sup>261</sup> Even though federal agencies and financial institutions deployed mortgage loss mitigation initiatives designed to help borrowers avoid foreclosure, the mortgage servicing practices significantly hindered the efficacy of these measures.<sup>262</sup>

We know from the recent foreclosure crisis that servicer incentives do not align with either the loan investors’ needs and interests or the borrowers’ needs and

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WNZC]; Letter from James L. Preston, Pa. Higher Educ. Assistance Agency, to Monica Jackson, Off. of the Exec. Sec’y, Consumer Fin. Prot. Bureau (July 9, 2015), <https://www.regulations.gov/document?D=CFPB-2015-0021-0974> [https://perma.cc/XJM4-SXRK]. As the Bureau has noted in other publications, there remain questions about the scale of these programs. For further discussion of alternative repayment programs and private student loans, see CONSUMER FIN. PROT. BUREAU, ANNUAL REPORT OF THE CFPB STUDENT LOAN OMBUDSMAN 18–32 (2015). See also Kevin Wack, *Wells Fargo, Discover to Start Modifications of Student Loans*, AM. BANKER (Nov. 20, 2014, 5:15 PM), <https://www.americanbanker.com/news/wells-fargo-discover-to-start-modifications-of-student-loans> [https://perma.cc/7YNT-TXW2].

255. GAO-19-430, *supra* note 16, at 11.

256. STUDENT LOAN SERVICING, *supra* note 252, at 25–31.

257. NAT’L CONSUMER L. CTR., *supra* note 140, § 12.7.3

258. The reasons given for not offering rehabilitation programs include low delinquency and default rates, availability of pre-default payment programs, operational uncertainties, reduced borrower incentives to avoid default, and risk of compliance violations. GAO-19-430, *supra* note 16, at 11–12.

259. STUDENT LOAN SERVICING, *supra* note 252, at 25 (“Comments from individual student loan borrowers and organizations representing public service workers note that servicers of both private and federal student loans may not inform borrowers experiencing financial hardship about available alternative repayment plans.”).

260. *Id.* at 27.

261. *Id.* at 70.

262. *Id.* at 12; *Problems in Mortgage Servicing from Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 111th Cong. (2010) (statement of Thomas J. Miller, Iowa Att’y Gen.).

interests.<sup>263</sup> We also learned from the foreclosure crisis that mediation can help both borrowers and lenders resolve this problem.

An analysis by Alan M. White of the empirical research and data measuring the effectiveness of foreclosure mediation found that mediation significantly increases the likelihood of better outcomes.<sup>264</sup> Mediation can also increase participation rates and rates of successful negotiations.<sup>265</sup> The better outcomes are not limited to just within the mediation itself but can have a lasting effect on subsequent redefault rates.<sup>266</sup>

Some of the success from mediation may be the result of simply monitoring the loan servicing industry. A study by J. Michael Collins and Carly Urban looked at the impact of Maryland's emergency servicer reporting requirement (ESRR) policy which was implemented before federal loss mitigation programs, such as the federal Home Affordable Modification Program (HAMP), were launched.<sup>267</sup> The ESSR policy simply required mortgage servicers to report on the effort to help homeowners facing foreclosure without any requirement to offer a specific loss mitigation option or sanctions from noncompliance.<sup>268</sup> Prior to the implementation of the ESRR, mortgage loan servicers, much like student loan servicers, adopted a "do nothing" strategy while "facing opaque information about a borrower" which creates a "status quo bias."<sup>269</sup> The study found that "[s]upervision changes this dynamic, making modifications and foreclosures the primary alternatives and leaving doing nothing as an inferior option."<sup>270</sup>

#### B. Utilization of Student Loan Mediation by Bankruptcy Courts

Two bankruptcy court districts, Middle District of Florida and Southern District of New York, have already implemented mediation programs to help deal with the mounting student debt crisis.<sup>271</sup> The programs' designs are based upon

263. Levitin & Twomey, *supra* note 133.

264. Alan M. White, *Foreclosure Diversion and Mediation in the States*, 33 GA. ST. U. L. REV. 411, 450 (2017).

265. *Id.* at 420 n.59.

266. *Id.* at 423. This conclusion is based upon a study by J. Michael Collins and Carly Urban of three Florida judicial districts. See J. Michael Collins & Carly Urban, *Mandatory Mediation and the Renegotiation of Mortgage Contracts*, 125 ECON. J. 1734, 1739–40 (2015).

267. J. Michael Collins & Carly Urban, *The Dark Side of Sunshine: Regulatory Oversight and Status Quo Bias*, 107 J. ECON. BEHAV. & ORG. 470 (2014).

268. 35 Md. Reg. 1183 (June 20, 2008).

269. Collins & Urban, *supra* note 267, at 473; see also Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSPS. 193 (1991); William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988).

270. Collins & Urban, *supra* note 267, at 473.

271. The Student Loan Management Program for the Middle District of Florida became effective in October 1, 2019. See Third Amended Administrative Order Prescribing Procedures for Student Loan Management Program (Bankr. M.D. Fla. Sept. 20, 2019) (Administrative Order FLMB-2019-5). The Student Loan Mediation Program for the Southern District of New York became

mortgage mediation programs utilized by the same courts during the foreclosure crisis which have had great success in reducing litigation.<sup>272</sup> The judiciary's goals in creating such a program are to "facilitate communication and the exchange of information in an efficient and transparent manner, and to encourage the parties to consensually reach a feasible and jointly beneficial agreement under the administrative oversight" of the bankruptcy court.<sup>273</sup>

Both programs apply to government and private student loans no matter what type of institution the student attended. Though neither program requires a lender to add or modify existing repayment options, good faith participation is required.<sup>274</sup> Each program also requires an open and transparent exchange of information with set time frames including a time and process for requesting to participate in the program.<sup>275</sup> The Southern District of New York requires that the debtor first apply for a student loan repayment option directly with the creditor, and only if there is no response within forty-five days of mailing the application or if the response received was inconsistent with the results provided by the application can the debtor be eligible for the program.<sup>276</sup>

Neither program has been in operation long enough to produce data on their efficacy, but their adoption shows judicial support for mediation and the usefulness of the foreclosure mediation analogy.

### *C. Private Student Loans Mediation Act Features*

#### *1. Loans Subject to the Act*

Much like the PSBPA, the goal of PSLMA is to apply to all private loans that are provided by for-profit higher education institutions. But the Act would also

effective in January 27, 2020. See Adoption of Student Loan Mediation Before Litigation Program Procedures (Bankr. S.D.N.Y. Jan. 27, 2020) (General Order M-536).

272. See Tammy Branson & Christie D. Arkovich, *Student Loan Management Program in the United States Bankruptcy Court for the Middle District of Florida*, 88 BRIEFS 8 (Jan. 7, 2020), <https://www.orangecountybar.org/news/student-loan-management-program-in-the-united-states-bankruptcy-court-for-the-middle-district-of-florida/> [<https://perma.cc/NLN3-ZV6V>]. Tammy Branson and Christine Arkovich are members of the Student Loan Committee for the U.S. Middle District of Florida. *Id.*

273. Third Amended Administrative Order Prescribing Procedures for Student Loan Management Program, *supra* note 271, ¶ 1.

274. *Id.* ¶ 7(a) (defining good faith as "The Required Parties shall act in good faith throughout the SLM Period. Good faith includes, but is not limited to, promptly responding to all inquiries through the Portal and providing all requested documentation and information."); Adoption of Student Loan Mediation Before Litigation Program Procedures, *supra* note 271, ¶ VII (defining good faith, which is required when SLM parties negotiate, as "includ[ing] a duty by the Creditor to accept a Debtor's postpetition Student Loan payments as provided by the SLM Program and Local Rule 9019-3. A Party that fails to participate in SLM in good faith may be subject to sanctions.").

275. Third Amended Administrative Order Prescribing Procedures for Student Loan Management Program, *supra* note 271, ¶¶ 1, 5, 9–11; Adoption of Student Loan Mediation Before Litigation Program Procedures, *supra* note 271, ¶¶ I, III.

276. Adoption of Student Loan Mediation Before Litigation Program Procedures, *supra* note 271, ¶ III(B).

apply to nonprofit higher education institutions that contract out all of their services to for-profit entities in order to address the concerns discussed above. Each component of these definitions is further discussed below.

The PLMSA expressly excludes government loans made, insured, or guaranteed under the Higher Education Act<sup>277</sup> and defines *private student loans* as

[a loan that] is issued expressly for postsecondary educational expenses to a borrower, regardless of whether the loan is provided through the educational institution that the subject student attends or directly to the borrower from the private educational lender.<sup>278</sup>

The PSLMA defines *for-profit educational institution* by first incorporating the definition for higher education as found in the HERA.<sup>279</sup> The PSLMA then goes a step further to also encompass “private nonprofit institution[s] of higher education” to address the problem of a nonprofit substantially operated or controlled by a for-profit institution.

The PSLMA borrows the definition of “private nonprofit institution of higher education” as defined by recently amended Maryland Code of Education section 10-101(k).<sup>280</sup> The statute previously defined a “private nonprofit institution of higher education” as a higher education that generally limits enrollment to graduates of secondary schools and awards degrees at the associate, baccalaureate, or graduate level and included an independent institution of higher education within the definition.<sup>281</sup> House Bill 461 alters the definition of “private nonprofit institution of higher education” to mean, in addition to current criteria, that the institution “(i) benefits no person through any part of its net earnings; (ii) [i]s legally authorized to operate as a nonprofit organization in each state in which it is physically located; [and] (iii) [i]s determined by the Internal Revenue Service to be an organization to which contributions are tax-deductible . . . .”<sup>282</sup> The bill also explicitly states that “[p]rivate nonprofit institution of higher education’ does not include an institution engaging in a reportable incident unless the Commission has determined that the incident does not constitute private inurement.”<sup>283</sup> The bill goes on to define what a reportable incident is and requires the Maryland Higher Education Commission (MHEC) to determine whether an incident constitutes private inurement.<sup>284</sup> Under

277. See, e.g., 20 U.S.C. §§ 1070a, 1070b, 1070d-33, 1070g-1, 1070h, 1071, 1087-53, 1087a, 1087aa.

278. See *infra* Appendix B.

279. 20 U.S.C. § 1001(a)(1)–(3), (b).

280. MD. CODE ANN., EDUC. § 10-101(k) (West 2019).

281. 2019 MD. LAWS 3040.

282. EDUC. § 10-101(k)(1)(i)–(iii).

283. *Id.* § 10-101(k)(3).

284. *Id.* § 10-101(o) (“‘Reportable Incident’ means any of the following as reportable on a private nonprofit institution of higher education’s Form 990 of the Internal Revenue Service: (1) The engagement in an excess benefit transaction with a disqualified person; (2) The providing of a grant or other assistance by the institution to a member of the governing body; (3) The reporting of receivables from or payables to a member of the governing body; (4) The institution was a party to a business transaction connected to a member of the institution’s governing body; (5) The institution was a party

the Commission's regulations, institutions are allowed to engage in corrective action to have their classification returned to nonprofit status.<sup>285</sup>

The bill was brought about in response to the Higher Learning Commission, an accreditor, changing their guidelines to allow for an arrangement in which an institution set up as a nonprofit may outsource a range of services to a separate for-profit company.<sup>286</sup> Though, as argued above, the problem of covert nonprofits by for-profit institutions is an IRS enforcement issue, states feel obliged to monitor covert nonprofit institutions and take certain action to protect students, such as requiring an institution to provide financial guarantees.<sup>287</sup> Because an institution's status as a nonprofit can evolve throughout its tenure, the PSBPA did not include this more expansive definition. However, the PSLMA is applicable on defaulted private student loans before legal proceedings are initiated when students may be most in need of guarantee funds or other state protections established to benefit for-profit school attendees.

## 2. *Amount in Default*

The PSLMA as proposed in Appendix B is applicable to all private student loans from for-profit institutions no matter the amount of default. This is, in large part, because of the variability in small claims court civil jurisdiction thresholds across the nation.<sup>288</sup> Some courts set their threshold as low as \$3,500 to as high as \$25,000.<sup>289</sup> Other states, such as California, have an even more complicated small claims threshold with exceptions.<sup>290</sup> The thresholds of small claims courts are likely to influence the scope and application of PSLMA of a particular jurisdiction.

Another factor to consider is the debt loads of those that are currently struggling to make their payments. According to the Federal Reserve Board, of those borrowers behind on their payments eighteen percent of borrowers owe less than \$10,000 of outstanding debt, twenty-two percent owe between \$10,000 and

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to a prohibited tax shelter transaction; (6) The institution participated in an equity-based compensation arrangement; or (7) The institution paid compensation contingent on the revenue of the institution or any related organization.”).

285. MD. CODE REGS. 13B.01.03.07 (2020).

286. H.B. 461, 2019 Gen. Assemb., Reg. Sess. (Md. 2019), [http://mgaleg.maryland.gov/2019RS/fnotes/bil\\_0001/hb0461.pdf](http://mgaleg.maryland.gov/2019RS/fnotes/bil_0001/hb0461.pdf) [<https://perma.cc/FDE8-8VFM>]; see also Mills, *supra* note 217; Shireman, *supra* note 217, at tbl.1.

287. Memorandum from Emily A.A. Dow, Ph.D., Assistant Sec'y, Academic Affairs, to Md. Higher Educ. Comm., Final Approval of New COMAR Regulations – Private Inurement by Nonprofit Institutions of Higher Education 13, 15 (Jan. 22, 2020), <https://mhec.maryland.gov/About/SiteAssets/Lists/Meeting%20Agendas%20and%20Agenda%20Books/EditForm/CommBook1-22-20.pdf> [<https://perma.cc/N5AX-W82E>].

288. WILLIAM E. RAFTERY, CIVIL JURISDICTION THRESHOLDS (2015), [https://www.ncsc.org/\\_\\_data/assets/pdf\\_file/0014/16160/civil-jurisdiction-thresholds-history.pdf](https://www.ncsc.org/__data/assets/pdf_file/0014/16160/civil-jurisdiction-thresholds-history.pdf) [<https://perma.cc/UR9U-6AXP>].

289. ARIZ. REV. STAT. ANN. § 22-503A (2014); TENN. CODE ANN. § 16–15–501(d)(1) (West 2009).

290. CAL. CIV. PROC. CODE §§ 116.210–116.270 (West 2003).



\$24,999 of debt, and sixteen percent owe more than \$100,000.<sup>291</sup> Though these numbers are not particular to private student loan debts, they offer some insight on the impact on the program size when setting a default threshold amount.

### *3. Required Communication and Disclosure*

The PSLMA seeks to bridge this disparity between federal and private student loans by providing private student loan borrowers an opportunity to fully discuss their repayment plan or loss mitigation options in a facilitated mediation. Facilitated mediation, however, would expedite communication between a struggling private student loan borrower and their lender by first requiring the lender to send a notice of default and right to cure thirty days prior to initiating any legal proceeding. The notice will provide essential information to the borrower including the nature of default and the specific action required to cure, and provide the borrower an opportunity to dispute the default and raise any other defenses. In addition, the PSLMA would require an exchange of information prior to the mediation session itself.

The PSLMA would require lenders to disclose to borrowers the loss mitigation options available to them. By doing so, the Act lifts the veil of confusion and steering of borrowers into more costly options.

Mediation will also help lenders address the proportionally higher student default rates for private loans from for-profit institutions.<sup>292</sup> The PSLMA requires servicers to fully assess and communicate with student borrowers. With mediation acting as a last resort, borrowers will be less likely to default as the borrower works together with the lender to revise their repayments and avoid default.

### *4. Mediation Costs*

The PSLMA may increase operating costs to lenders and impose minor delays before pursuing a default against private borrowers. However, the model act sets the cost of facilitated mediation at the current market rate for mediation with both parties paying half the cost unless there is a determination by a facilitator that justice requires an alternative payment.

The cost will be further mitigated by fewer defaulting borrowers and a higher standard of repayment plans. The private student loan lenders admit that offering post-default rehabilitative programs could help banks recover some of the

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291. *Report on the Economic Well-Being of U.S. Households in 2018-May 2019*, BD. GOVERNORS FED. RSRV. SYS., <https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-student-loans-and-other-education-debt.htm> [https://perma.cc/W2JN-J7CH] (Jan. 30, 2020).

292. According to the Federal Reserve Board, more than one-fifth of borrowers who attended private for-profit institutions are behind on student loan payments, versus eight percent who attended public institutions and five percent who attended private not-for-profit institutions. *Id.*

nonperforming debt and could be marketed to borrowers as a benefit offered by the bank.<sup>293</sup>

It can also help loan servicers improve their overall service performance which could ultimately avoid them having to pay millions in penalties.<sup>294</sup> This assertion is supported by the research evaluating foreclosure mediation programs, which evaluated five years of foreclosure data and strongly suggested that the marginal delay for well-run mediation programs imposes modest costs, particularly compared to the benefits of successful mediation.<sup>295</sup> Regrettably, there is no true cost-benefit analysis because of the variability of mediation programs and student loan servicer loss mitigation options. But much could have been said of foreclosure mediation programs, yet all subsequent analysis supports the cost effectiveness of mediation.

### 5. Good Faith Requirement

Every contract governed by the Uniform Commercial Code (UCC) has an obligation of good faith and fair dealing (section 1-304). Private lenders must show good faith and fair dealing to avoid misleading or defrauding borrowers, similar to common commercial standards. At or before the mediation, lenders must make diligent efforts to inform the borrower of foreseeable duties and consequences for each available option offered by the private student loan lender. Inclusion of a good faith requirement within the Private Student Mediation Act is an essential component to achieve the prodding function that will require student loan services to fully evaluate borrowers for options when there is no other incentive for them to do so.

However, the Uniform Mediation Act emphasizes the confidentiality of mediators, which may limit their ability to report on the level of engagement of the parties in the process.<sup>296</sup> Even though most foreclosure programs keep the financial and policy records confidential, the concern is that requiring mediators to report on how forthcoming the parties were within mediation will hamper the parties' willingness to participate and jeopardize the mediator's neutrality.

But an evaluation of the good faith requirement as applied in foreclosure mediation instead emphasizes the need for clear requirements and expectations within the rules to ensure enforceability and accountability.

"New York and Nevada are the two states with the most reported cases applying a broad duty to negotiate in good faith . . . in [which] virtually all cases" tie

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293. GAO-19-430, *supra* note 16, at 12.

294. See Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0013 ¶¶ 73, 79 (Aug. 22, 2016), in which Wells Fargo was required to pay \$3.6 Million penalty to the Consumer Financial Protection Bureau and \$410,000 in consumer refunds.

295. White, *supra* note 253, at 11.

296. UNIF. MEDIATION ACT § 8 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2003) ("Unless subject to the [insert statutory references to open meetings act and open records act], mediation communications are confidential to the extent agreed by the parties or provided by other law or rule of this State.").

servicer misconduct “either to violations of specific program requirements . . . or to some type of misrepresentation.”<sup>297</sup> In fact, New York amended the Mandatory Settlement Conference Act in 2009 to expressly require good faith negotiation.<sup>298</sup> This legislation was passed in part because “[a]s the mortgage crisis . . . worsened . . . it . . . bec[a]me evident that more must be accomplished to protect New Yorkers in these difficult times and beyond.”<sup>299</sup> Once the law was passed a lower New York state court stated it had an “affirmative obligation to ensure that the primary statutory goal of keeping homeowners in their homes, and the concomitant obligation of ensuring that the parties act in good faith, are met.”<sup>300</sup> Given that the complaints surrounding private student loan servicing echo the same concerns raised by homeowners during the foreclosure crisis, one could argue mediation could be equally effective in ensuring borrowers are fully evaluated for all their options.

Common problems in foreclosure mediation programs echo the concerns of student loan borrowers in dealing with their servicers, such as not appearing “with an authorized representative who could make decisions on loss mitigation questions,” unduly delaying application decisions, or failing “to give reasonable explanations for their decisions,”<sup>301</sup> all of which resulted in sanctions against the servicers for failing to mediate in good faith.

Such findings have been imposed whether or not there has been an underlying modification program in which mortgage servicers must offer. The Suffolk County Supreme Court sanctioned a subprime lender that appeared at a settlement conference with “no good faith intention whatsoever of resolving [the] matter in any manner other than a complete and forcible devolution of title . . . .”<sup>302</sup> *Wells Fargo Bank, N.A. v. Hughes* illustrates the court’s frustration and ability to hold servicers accountable when they fail to adhere to the purpose of the mediation enabling statutes:

The terms of the proposed Modification Agreement, particularly but not exclusively the inclusion of an adjustable rate component, are unacceptable

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297. White, *supra* note 253, at 24. Violations of program requirements include “timely participation, timely action on, and accurate communication regarding homeowner loss mitigation applications.” *Id.*

298. N.Y. C.P.L.R. 3408(f) (McKinney 2017).

299. *Wells Fargo Bank v. Hughes*, 897 N.Y.S.2d 605, 608 (Sup. Ct. 2010) (quoting S. ASSEMB. B. 236-507, 7th Sess., at 9 (N.Y. 2009), <http://digitalcollections.archives.nysed.gov/index.php/Detail/objects/22742> [<https://perma.cc/RXZ8-2AFN>]).

300. *Bank of Am. v. Rausher*, 981 N.Y.S.2d 269, 272 (Sup. Ct. 2014) (citations omitted).

301. GEOFF WALSH, NAT’L CONSUMER L. CTR., *REBUILDING AMERICA: HOW STATES CAN SAVE MILLIONS OF HOMES THROUGH FORECLOSURE MEDIATION* 7 (2012) (“Sanctions have included monetary penalties, orders for servicers to bring in a qualified representative to negotiate, orders tolling accrual of interest and fees during periods of delay, and orders to modify a loan.”). Some courts have gone as far as prohibiting a foreclosure sale or dismissing a judicial foreclosure case with prejudice, thus preventing the servicer from re-filing the claim. *Id.*

302. *IndyMac Bank F.S.B. v. Yano-Horoski*, 890 N.Y.S.2d 313, 315 (Sup. Ct. 2009) (applying N.Y. COMP. CODES R. & REGS. tit. 22, § 130-1.1 (1998)).

to this Court. The proposed Modification Agreement flies in the face of the . . . legislation . . . which was designed to assist borrowers in foreclosure cases to remain in their homes and to prevent a foreclosure crisis like the one currently gripping this state and the nation from reoccurring in the future.<sup>303</sup>

The court went on to find “Wells Fargo has acted in bad faith and contrary to CPLR § 3408 by presenting Hughes with the Modification Agreement [with an adjustable rate and unaffordable payment] . . . and, notwithstanding, the Court’s directive, obstinately refusing to revise its terms in accordance with the stated intention of the Legislature.”<sup>304</sup>

However the courts are limited in the sanction they can impose as they cannot change the settlement parameters of the parties or require particular contract terms.<sup>305</sup> In fact, “a determination not to modify a mortgage loan by a foreclosing bank that is under no legal obligation to modify such a loan . . . does not constitute bad faith.”<sup>306</sup>

Though the PSLMA may shed light on the inconsistent and unfair practices of the private student loan servicers and even raise the status quo of industry practice, it is just one of the tools to help the most vulnerable student borrowers that have otherwise been ignored by regulators.

#### *D. Constitutional Validity of the PSLMA*

Though this proposal would have a retroactive effect upon all private student loan contracts in collection, mandatory mediation before collecting a student loan default does not impair the obligation of contracts.<sup>307</sup> Though a retroactive law that deprives a person of a vested property right may constitute a taking,<sup>308</sup> “[t]he threshold inquiry is ‘whether state law has, in fact, operated as a substantial impairment of a contractual relationship.’”<sup>309</sup>

The next step, as specified by the Supreme Court, is to apply a level of scrutiny proportional to the magnitude of the contractual burden identified in the first step. “If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation,” and then after “a legitimate public purpose has been identified, the next inquiry is whether the adjustment . . . [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation’s

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303. 897 N.Y.S.2d. at 609.

304. *Id.*

305. *Negron v. Woodhull Hosp.*, 173 F. App’x. 77, 79 n.1 (2d Cir. 2006) (“[A] party is not required to change its settlement parameters by reason of a court order to attend a settlement conference.”).

306. *See JP Morgan Chase Bank, N.A. v. Ilardo*, 940 N.Y.S.2d 829, 843–44 (Sup. Ct. 2012).

307. U.S. CONST. art. I, § 10, cl. 1.

308. *E. Enters. v. Apfel*, 524 U.S. 498 (1998).

309. *Energy Rsrvs. Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411 (1983) (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)).

adoption].”<sup>310</sup> In *Home Building & Loan Ass’n v. Blaisdell*, the Supreme Court found that since “the contract clause is not an absolute and utterly unqualified restriction of the States’ protective power,” the state was justified in passing legislation to protect the vital and basic interests of the community especially when the legislation was connected to the interests of all parties affected.<sup>311</sup>

“[S]tate regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment.”<sup>312</sup> One factor in determining the extent of the impairment is whether or not the industry “has been regulated in the past.”<sup>313</sup> Since 1965, with the enactment of Higher Education Act, the student loan market has been regulated. While this Act primarily served to provide protections for federal student aid, it also puts restrictions on funding for for-profit private student loans and increases the pressure on these schools from attaining funds from nonfederal sources. But this is just one act in a heavily regulated industry as evidenced by the HEA Reauthorization Act (1972), Student Aid and Fiscal Responsibility Act (2010), and Health Care and Education Reconciliation Act of 2010 (HCERA).

Federal courts have permitted retroactive application of civil legislation without finding a violation of the Fifth Amendment Takings Clause.<sup>314</sup> Therefore, as currently applied by the federal courts, the Supreme Court’s Fifth Amendment Takings Clause jurisprudence “opens a door for constraints on retroactivity but will only apply in relatively extreme cases.”<sup>315</sup> A taking of a contract can occur when the government itself seizes the rights of the parties under the contract.<sup>316</sup> The test, as articulated by the Supreme Court in *Omnia Commercial Co.*, is whether the government has “appropriated” the parties’ contractual rights or merely “frustrated” them.<sup>317</sup> These cases deal with the “taking” of a contract right after it has been created, and not with the “taking” of the right to contract freely. A state

310. *Id.* at 411–12. (alteration in original).

311. *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 447 (1934). In this case, the Act allowed for an extension of the redemption period for foreclosure sales. *Id.* at 416.

312. *Energy Rsrvs. Grp., Inc.*, 459 U.S. at 411 (citing *U.S. Tr. Co. of N.Y. v. New Jersey*, 431 U.S. 1, 31 (1977); *El Paso v. Simmons*, 379 U.S. 497, 515 (1965)).

313. *Id.* (citing *Allied Structural Steel Co.*, 438 U.S. at 242 n.13; *Veix v. Sixth Ward Bldg. & Loan Ass’n*, 310 U.S. 32, 38 (1940)).

314. *See Quarty v. United States*, 170 F.3d 961, 968–70 (9th Cir. 1999); *Willoughby Dev. Corp. v. Ravalli Cnty.*, 338 F. App’x 581, 583 (9th Cir. 2009); *In re Thompson*, 867 F.2d 416, 422 (7th Cir. 1989); *Am. Express Travel Related Svcs., Inc. v. Sidamon-Eristoff*, 669 F.3d 359, 370–72 (3d Cir. 2012).

315. WILLIAM J. RICH, *MODERN CONSTITUTIONAL LAW* 677 (3d ed. 2011).

316. When the government, for war purposes, requisitioned the entire production of a steel manufacturer, rendering impossible and unlawful performance of an outstanding contract between the manufacturer and a customer, the customer’s rights were not taken by the government, but frustrated by its lawful action. *Omnia Com. Co. v. United States*, 261 U.S. 502, 513 (1923); *cf. Lynch v. United States*, 292 U.S. 571, 579 (1934) (“The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, municipality, a state, or the United States.”).

317. *Omnia Com. Co.*, 261 U.S. at 511–12.

shall not pass a law revoking, invalidating, or altering a contract, but a court may order mediation or other alternative dispute resolution as a process step to invoking the judicial system for powers of collection. Similar to court-ordered pretrial alternative dispute resolution, mediation of private student loan debt collections allows an impartial third party to facilitate communication and ensure good faith requirements have been met.

#### CONCLUSION

Private student loan borrowers do not have the right typically afforded to debtors with unsecured loans to discharge debt in bankruptcy, nor do they have the multitude of repayment and discharge rights afforded to federal student loan borrowers. For-profit higher education students have for decades been subject to abusive and deceptive practices. The intersection of these groups—for-profit school students with private education debt—consists of a group in substantial need of new consumer protections.

This Article has set forth two model laws that states may enact to bring protections to these forgotten borrowers. First, new private student loans entered into by for-profit school borrowers could include many of the protections given to federal student loan borrowers through the use of mandated contract terms under state law. Second, private student loans to for-profit school students that end in default should be enforceable only if the lender engages in mediation in an effort to reach a loan modification or other settlement of the outstanding debt. We rely on successful federal and state consumer protections—the FTC Holder Rule and state foreclosure mediation laws—as support for the workability of the concepts underlying these proposals.

## APPENDIX A: MODEL ACT #1

## PRIVATE STUDENT BORROWER PROTECTION ACT

**Section 1. Citation.** Sections \_ to \_ shall be cited as the [state] Private Student Borrower Protection Act.

**Section 2. Scope and Application.** The following words and terms where used in the [state] Private Student Borrower Protection Act shall have the meanings ascribed to them in this section.

“Covered loan” means a private student loan to a covered student.

“Covered student” means a student attending a proprietary institution—

- i. and the proprietary institution has a physical presence in this state; or
- ii. the student is a resident of this state, as defined under [insert]<sup>318</sup>, and the proprietary institution provides the course of study for the student through distance education.

“Distance education” means [insert].<sup>319</sup>

“Federal student loan” means a student loan made by the United States government or any agency of the United States government.

“Lender” means a person who makes a covered loan.

“Physical presence” [insert].<sup>320</sup>

“Private student loan” means a loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual, unless that educational loan is made, insured, or guaranteed by a governmental unit, including a federal student loan, or is made under any program funded in whole or in part by a government unit or a nonprofit institution substantially affiliated with a government unit.<sup>321</sup>

“Proprietary institution” means a higher educational institution in any State that—

- i. meets the definition of a “proprietary institution of higher education” in 20 U.S.C. § 1002(b); or

318. A state should adopt an appropriate definition of residency by reference to existing state law.

319. Most states have existing law defining “distance education,” “physical presence,” or analogous concepts. *See, e.g.*, TENN. CODE ANN. § 62-13-325 (West 2009). The National Council for State Authorization Reciprocity Agreements offers model definitions for these terms. NAT’L COUNCIL FOR STATE AUTHORIZATION RECIPROCITY AGREEMENTS, *supra* note 229, § 1, at 11 (“‘Distance Education’ means: instruction offered by any means where the student and faculty member are in separate physical locations. It includes, but is not limited to, online, interactive video and correspondence courses or programs.”). Physical presence is discussed at length in the SARA Manual. *Id.* § 5.10, at 40–41.

320. *See supra* note 319.

321. This language is adapted from the bankruptcy discharge exception provision. *See* 11 U.S.C. § 523(a)(8).

ii. is a nonprofit institution substantially operated or controlled by a for-profit institution and would meet the definition of a “proprietary institution of higher education” in 20 U.S.C. § 1002(b) except for being a nonprofit institution.

**Section 3. Required Rights in Loan Contract.** In connection with the origination of any covered loan, the lender shall include in the loan contract the following provisions:

“For purposes of these contract provisions required under the [state] Private Student Borrower Protection Act, ‘federal student loan’ means student loan made by the United States government.

“Eligibility for Federal Student Loan Discharge. Notwithstanding any other provision of this contract to the contrary, any holder of this loan contract shall accept as full payment and satisfaction of all obligations of the borrower any of the following:

“(1) Either: (a) proof that the borrower has obtained a discharge of a federal student loan for reason of death or disability; or (b) proof equivalent to that required for a borrower to discharge a federal student loan for reason of death or disability under 20 U.S.C. § 1087(a) or regulations adopted thereunder.

“(2) Either: (a) proof that the borrower has obtained a discharge of a federal student loan for reason of the closure of the school attended or false certification of eligibility for a federal loan; or (b) proof equivalent to that required for a borrower to discharge a federal student loan for reason of school closure under 20 U.S.C. § 1087(c) or regulations adopted thereunder.

“Alternative Income-Based Repayment. Notwithstanding any other provision of this contract to the contrary, the borrower shall not be in default if the borrower makes periodic payments on this loan equal to the *share available to the holder of this contract* of the *private student loan repayment limit*. For purposes of this provision, the *private student loan repayment limit* shall be equal to thirty percent of the periodic amount owed by the borrower on an income-based repayment program under which the borrower is obligated to repay all of the borrower’s federal student loans, except that this amount shall be calculated as the amount that would have been due to be repaid on the federal student loans through income-based repayment without regard to any prepayment of the federal student loans. For purposes of this provision, the *share available to the holder of this contract* shall be the *private student loan repayment limit* minus any periodic payments due by the borrower for this alternative income-based repayment for any private student loan originated at a date prior to the date of origination of this loan. If the borrower did not obtain federal student loans to attend the school for which proceeds of this loan were used to attend, the borrower shall not be in default if the borrower makes periodic payments on this loan equal to thirty percent of the periodic payments that would have been due for a federal student loan of the same amount under the Pay as You Earn program described in 34 C.F.R. § 685.209(a).”

**Section 4. Format of Required Provisions.** The contract provisions required by Section 3 shall be in at least 12-point type with italics and underline as



provided in Section 3. The contract provisions required by Section 3 shall be on a separate page from all other contract language except the provisions required, if any, under the Federal Trade Commission Preservation of Consumers' Claims and Defenses rule, 16 C.F.R. Part 433. The separate page with the required contract provisions shall include the following heading in 14-point, boldface type: "**Your Right to Alternative Loan Repayment and Discharge Under the [State Name] Private Student Borrower Protection Act.**"

**Section 5. Deception or Overshadowing.** No covered lender, proprietary institution, or other person shall, in connection with a covered loan, engage in statements or conduct that deceive or mislead persons provided or offered a covered loan about the rights provided under the Private Student Borrower Protection Act.

**Section 6. Enforcement.** Failure to include in a covered loan the contract provisions required by Section 3, breach of any of the contract provisions required by Section 3, or any other violation of the Private Student Borrower Protection Act shall constitute a violation of [state UDAP law].<sup>322</sup>

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322. Insert a reference to the appropriate state UDAP law and any corresponding public or private enforcement provisions, as appropriate.

## APPENDIX B: MODEL ACT #2

## PRIVATE STUDENT LOAN MEDIATION ACT

**Section 1. Citation.** Sections \_ to \_ shall be cited as the [state] Private Student Loan Mediation Act.

**Section 2. Scope and Application.** The following words and terms where used in sections \_ to \_ shall have the meanings ascribed to them in this Section. This legislation applies to Private Education Loans that are provided by For-Profit Higher Education Institutions and Nonprofit Higher Education Institutions that contract out all of their services to for-profit entities. The term “for-profit higher education institution” means an educational institution in any state that—

- i. falls under the definition of higher education as found in 20 U.S.C. § 1002(b);<sup>323</sup>
- ii. institution engaging in a reportable incident unless the [state commission] has determined that the incident does not constitute private inurement.

**Section 3. Definitions.**

**1. Facilitated Mediation.** A conference at which the parties in dispute over the collection of a private educational loan debt, their attorneys, additional representatives of the parties, or a combination of those persons appear before a facilitator to discuss the positions of the parties in an attempt to reach agreement on a loss mitigation program for the student borrower and lender.

**2. Loss Mitigation Program.** An alternative payment structure offered in connection with an attempt to repay a private educational loan that:

Protects the Borrower from the adverse effects of default on private education loans, including, but not limited to:

Negative credit reporting;

Accelerated payments; and

Collection actions;

Accounts for the borrower’s ability to reasonably repay the private educational loan, considering

Adjusted gross income;

Local cost of living; and

Other factors contributing to financial hardship.

**3. Private Educational Lender (Lender).** Any person, its agents, subsidiaries, or affiliates engaged in the business of soliciting, making, servicing, collecting, or extending private education loans.

**4. Private Education Loans.** A loan provided by a private educational lender that—

- (i) is not made, insured, or guaranteed under of title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 et seq.);

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323. Language taken from the Higher Education Act. 20 U.S.C. § 1002(b).

(ii) is issued expressly for postsecondary educational expenses to a borrower, regardless of whether the loan is provided through the educational institution that the subject student attends or directly to the borrower from the private educational lender;

**5. Facilitator.** A natural person who is trained to mediate disputes but may inform and discuss with both parties the rights of each party.

**6. Default.** The nonpayment of a debt obligation within the contractually obligated period, but before any negative action has been taken on the Borrower.

**7. Borrower.** A natural person who has agreed to take out the Private Education Loan and is obligated to make repayment on the Private Education Loan.

**8. Good Faith.** Means honesty in fact and the observance of reasonable commercial standards of fair dealing.

**Section 4. Prohibited Acts, Notice of Default, Right to Cure.**

a. No Lender may initiate any legal proceeding based upon the collection of a debt against Borrower until thirty days after Lender sends separately to Borrower a written notice of default and right to cure.

b. The notice under this section must state—

i. the nature of the default, including a statement, as of the date of the notice, of all past-due payments, fees, and other charges owed to the Lender;

ii. the specific action the Borrower must take to cure any curable default, including the exact amount that must be paid, all payment methods permitted by Section \_\_, and any other payment method acceptable to the Lender;

iii. the date by which the default must be cured, which may not be fewer than thirty days after the date the notice is sent;

iv. the effect of curing the default, including the right to have the obligation remain in effect;

v. that Borrower may dispute the default and raise any other defense or payment of the obligation or the manner of exercising those rights;

vi. the name of:

(1) Lender and the facts that establish Lender's right to collect under Section \_\_;

(2) the legal owner of the obligation, if Lender is not the legal owner;

(3) that Borrower may request a copy of the negotiable instrument or other evidence of the obligation and a copy of any record that demonstrates the right to foreclose; and

(4) if Borrower is relying on a lost, destroyed, or stolen negotiable instrument, the information required by Section \_\_.

c. The notice under this Section may contain additional information, including a statement that additional amounts will come due after the date of the notice.

**Section 5. Notice of Mediation.**

Before commencing any legal proceeding against Borrower, Private Educational Lender shall—

- i. request under Subsection (2) that the Facilitator send the Borrower notice of the right to participate in Facilitated Mediation; or
- ii. send the notice under Subsection (3).

If the Facilitator establishes a procedure for sending the notice required by Subsection (a) or (b), the Lender shall request the Facilitator to send the notice to the Borrower and the Facilitator shall promptly send the notice.

If the Facilitator does not establish a procedure for sending notice required by Subsection (a) or (b), the Lender shall send notice to Borrower—

- i. by first-class certified mail addressed to Borrower at the Borrower's last known address; and
- ii. by electronic mail to Borrower's electronic mail address.

A notice under this section of the right to participate in Facilitated Mediation must include the following:

- i. the name, address, telephone number, and electronic-mail address of the Lender;
- ii. a statement that the Borrower may request Facilitated Mediation and that the request must be made not later than thirty days after notice is sent;
- iii. the instructions for requesting Facilitated Mediation and all eligibility requirements under the Facilitator's rules;
- iv. a description of all documents that the Facilitator's rules require the Borrower to bring to the Facilitated Mediation; and
- v. a form prescribed by the Facilitator for the Borrower to request Facilitated Mediation and to affirm that the Borrower meets the eligibility requirements of Section \_.

**Section 6. Process for Facilitated Mediation.**

Borrower has thirty days to agree to the notice of mediation as proscribed in Section \_.

If Borrower accepts the opportunity to participate in facilitated mediation, the Private Educational Lender must notify Borrower and communicate with Borrower to determine a reasonable time within thirty days to schedule the facilitated mediation.

Parties must schedule Facilitated Mediation for a period no sooner than thirty days after the agreed schedule date.

Parties have until one week prior to the scheduled Facilitated Mediation to provide the opposing party with copies of all documents that will be used at Facilitated Mediation to show—

- i. ownership of the loan;
- ii. description and eligibility criteria for any private loan loss mitigation options;

- iii. current income of Borrower;
- iv. current assets of Borrower; and
- v. other documents necessary in order to resolve the dispute and determine an appropriate loss mitigation program.

All parties involved in the mediation outside of the Facilitator must have authority to settle the dispute for their respective side.

If Borrower rejects the opportunity to participate in Facilitated Mediations, the Borrower must notify Private Educational Lender in writing; and

Private Educational Lender must retain the rejection notification for its records for a period of [insert legal record keeping statute reference].

If Private Educational Lender is unable to obtain a rejection notification, [rebuttable presumption that lender did not attempt to offer facilitated mediation in good faith].

If Borrower and Private Educational Lender cannot reach an agreed mediation date within the period noted in Part 2 and failure was due to—

Private Educational Lender

Then Private Educational Lender may not attempt to collect on the debt.

Borrower

Then Private Educational Lender has a presumption of a good faith attempt at mediation.

**Section 7. Resolution of Facilitated Mediation.** If parties reach an agreement in Good Faith Facilitated Mediation, Private Educational Lender must file the agreement with the court clerk.

**Section 8. Funding.**

The cost of Facilitated Mediation will be based upon the current market rate for mediation services.

Borrower and Private Educational Lender must each pay half of the cost of Facilitated Mediation unless the Facilitator determines justice requires an alternative payment.

**Section 9. Good Faith and Fair Dealing.**

A Private Educational Lender whose conduct is governed by this Act shall comply in good faith and fair dealing with the requirements throughout the entire lending process, including, but not limited to negotiating process, lending process, and debt collection process.

The duty of good faith and fair dealing is implied in every lending contract, even though sometimes not mentioned in the contract.

A Private Educational Lender shall be honest in fact and proceed in a commercially reasonable manner of fair dealing in complying with this Act. Factors determining “fair dealing” includes, but not limited to—

- i. parties having the authority to settle the dispute at the facilitated mediation;
- ii. parties making reasonable effort to communicate with each other and settle the dispute;

iii. litigation is only allowed after parties' efforts to negotiate fail and the settlement agreement seems reasonably futile; and

iv. Private Educational Lender shall not exercise any undue influence throughout the entire lending process.

If a Private Educational Lender proves to follow business norms in a reasonable manner by a preponderance of evidence, a breach of good faith and fair dealing requirement cannot be found.

Unless otherwise stipulated, a breach of good faith and fair dealing cannot be an independent cause of action; but a breach of covenant of implied good faith and fair dealing can be a cause of action.

Unless otherwise stipulated, the duty of good faith and fair dealing shall continue until the lending contract is fully performed.

#### **Section 10. Civil Action, Remedies.**

**Cause of Action.** If a Private Educational Lender violates any provision of sections \_ to \_, Borrower may bring an injunction action to prevent collection of the Private Educational Loan and may be awarded attorney's fees and costs.

**Damages.** If a court finds repeated attempts to collect on a Private Educational Loan that does not satisfy the requirements of sections \_ to \_, during the cure period, while Facilitated Mediation is pending, or after being enjoined, the violating party will be liable for—

- i. actual damages;
- ii. statutory damages of [insert viable amount];
- iii. attorney's fees;
- iv. costs and disbursements; and
- v. any other equitable relief as determined by the court.

